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TRADE ISSUES AND TRADE PROSPECTS FOR THE MID-ATLANTIC REGION

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TRADE ISSUES AND TRADE PROSPECTS FOR THE MID-ATLANTIC REGION

FRIDAY, JUNE 15, 1984

UNITED STATES SENATE,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
OF THE COMMITTEE ON FOREIGN RELATIONS,
Baltimore, MD.

The subcommittee met, pursuant to notice, at 9:16 a.m., in the Police Administration Building Auditorium, 601 East Fayette Street, Hon. Charles McC. Mathias, Jr. (chairman of the subcommittee) presiding.

Present: Senators Mathias and Sarbanes.

Senator MATHIAS. This hearing of the International Economic Policy Subcommittee of the Committee on Foreign Relations of the U.S. Senate will come to order.

The first thing I would like to do is to express my appreciation and the appreciation of the committee to Commissioner Frank Battaglia of the city of Baltimore for inviting us to use these facilities at police headquarters. We are grateful to him not only for allowing us to be here, but for all the active assistance that Commissioner Battaglia has given us in making the arrangements for this meeting.

Over the past 30 months, the U.S. economy has undergone a deep and prolonged recession, which has put millions of Americans out of work, closed many plants, and shaken some of the mightiest of financial institutions.

After 4 years of enjoying a steady growth in exports, we have found that U.S. exports have fallen from a volume of $374 billion in 1981 to barely $300 billion in 1984. Unhappily, the impact of the recession has not been evenly distributed. Some of our most important industries, such as automobiles, steel, and textiles, have suffered very heavily.

Cities and States that depend on exporting have been hit the hardest, and the mid-Atlantic region has been faced with both domestic and with export setbacks. Here in the city of Baltimore, we have been hit with a double whammy, because we have both export trade and smokestack industries.

So by bringing the committee to Baltimore we hope to understand better the problems caused by the reversal of all the trends and the prospects in exports. I would set out for us this morning three purposes, three goals:

First, we want to look at the prospects for U.S. exports in the light of an overvalued dollar, a massive foreign debt, continued re-

cession abroad, and the tendency to resort to protectionism all around the world.

Second, I hope we can consider whether the present international trading system can meet the challenge that these forces pose.

Third, I hope that we will hear from local industries about the problems that they face in their efforts to export in this turbulent period and that we will get their recommendations about where the Government should focus its efforts to help U.S. industry.

The central issue is whether the United States can regain its competitiveness and what efforts and what policies will be required in order to do that.

I am glad to say that not all the news is bad. A great many industries are taking very impressive steps to meet the challenge of foreign competition. Industry investments to cut costs and to improve productivity are an important component of the recovery.

Here in Baltimore, all around us we can see the evidence of revitalization, despite the hard times that have come to the automotive, steel and and other basic industries which have been the economic foundation of Maryland. We see new growth in new areas.

Many of the new firms are in the forefront of the technologies of tomorrow: telecommunications and aerospace and electronics and biochemistry. And the same resilience can be seen in efforts by both private and government groups in Maryland and in the whole mid-Atlantic region—efforts to expand the regional potential, to compete and to provide jobs in a modern, technological world.

Certainly we are highly aware of these efforts and find them very important and very welcome. So we will look not only at the export problems facing Maryland and Baltimore and the mid-Atlantic region, but we want to look ahead at ways of increasing exports.

In this connection, I would like to acknowledge the cooperation and the very substantial assistance of the groups that have participated in organizing the 2-day seminar on public and private export services available in the region to assist area firms in expanding exports, a seminar which will continue through Monday and Tuesday of next week.

The sponsoring organizations include the Economic Development Council of Greater Baltimore, the Greater Washington Board of Trade, the Baltimore-Washington Regional Association, the U.S. Department of Commerce, Arthur Young & Co., and the Export Club of Baltimore.

I also want to express my appreciation to everyone who has made the early morning trip to Baltimore from Washington. It has been rewarding that people have been so willing to come and participate in this meeting, and we will shortly open the hearing by asking Mr. Volcker to join us.

But before that, let me first turn to my distinguished colleague Paul Sarbanes for any remarks that he may have.

Senator SARBANES. Thank you, Mr. Chairman. I will be very brief because the Senate is in session today and we may be subjected to some rollcalls. [Laughter.]

This is a very timely hearing. As we know, the trade deficit has risen to historic levels. From $69 billion in 1983, it is estimated to now rise to over $120 billion this year.

I am anxious to hear from the witnesses, and particularly from Chairman Volcker, with some focus on the questions of:

Dollar overvaluation which have been repeatedly raised as an important contributing factor to the difficulty we confront in our trade deficit;

The impact of the foreign-debt crisis, since it is clear that a good deal of our dropoff in export performance is related to exports to those countries which face major debt crises and have had to move to austerity programs internally in order to address their situation, which of course then has an impact on our own export performance;

The failure to synchronize, as it is, the expanding economies across the world, so that the U.S. economy is at the moment expanding, other economies are not, and you get that imbalance, which has a marked impact, I think, on trade flows;

And the whole question that has now arisen about unfair-trade practices and an increasing concern that a number of nations are taking very concerted steps, in effect, to underwrite their exports and in effect to render what one had thought was a fair trading, international fair-trading system, not to be such.

I think all of these matters are impacting on the trade-deficit question and confronting us with this major problem we have. I think it will be particularly helpful to hear from the business people who are actually engaged in commerce as to the difficulties they may encounter, the various obstacles which they run into in the ordinary course of their business which make it more difficult to export, and of course we would be anxious to take whatever measures we can in that regard to improve their prospects and possibilities.

Thank you, Mr. Chairman.

Senator MATHIAS. Thank you, Senator Sarbanes.

Chairman Volcker, if you would join us we would appreciate it.

I think Paul Volcker needs no introduction in any forum or in any part of the civilized world today, so I will not attempt to introduce him. But I would express my personal appreciation for the quality of his services to the American people and for the fact that he has been willing to take the heat and stay in the kitchen, which has been an extraordinarily valuable thing for the United States during a very difficult period in our economic history.

Mr. Chairman, the floor is yours.

STATEMENT OF HON. PAUL A. VOLCKER, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Chairman VOLCKER. Thank you, Senator. I might say initially that it is nice to be in a somewhat different setting than where we generally meet.

I am very much aware that Baltimore is in a key position of the international trading area, for the reasons that you indicated. It is a great port, but also a manufacturing center, so the issues that we are discussing today certainly are relevant to the locale.

I am pleased to have this opportunity to discuss the outlook for world trade and U.S. exports in light of the international debt situation and dollar interest rates and exchange rates.

The growth of international trade that we have witnessed over the past several decades has provided a vital boost to standards of living throughout the world. During the 1960's and the 1970's, the volume of world trade expanded at an average annual rate of about 7 percent. That expansion allowed countries with raw material resources and fertile agricultural lands to raise their income significantly by marketing their minerals and crops outside their borders. Apart from the exploitation of natural resources, the expansion of trade has also allowed countries to raise their living standards by devoting their labor and physical capital to larger scale production of manufactures and provision of services. The pressures of international competition associated with the expansion of world trade have encouraged the efficient use of resources, helped to restrain the forces of inflation, and fostered a continuing stream of new products and technologies that have pervasively affected the lives of us all.

The growth of world trade slowed markedly—in both volume and value—during the first 2 years of this decade and turned negative in 1982. To a large extent that performance reflected the recession and sluggish growth of economic activity in industrial countries. It was also affected by the slowdown of international lending to developing countries.

In 1983, the volume of world trade began to recover, and some forecasters are predicting growth on the order of 5 or 6 percent in 1984. The expansion of U.S. trade contributed importantly to the recovery of world trade last year, but, as most of you are intimately aware, that expansion occurred disproportionately on the side of our imports rather than our exports.

U.S. exports did increase moderately in value and volume terms during the four quarters of 1983. They continued to increase during the early months of this year, though the expansion has been outpaced by that of imports. Thus, today we face a number of serious economic policy concerns with international symptoms: our large and growing international trade deficits, the international debt situation, and the high value of the dollar.

In approaching these issues, I believe it is right to emphasize, first, that the past year and more has been one of vigorous economic advance in the United States. That in turn has been a powerful force assisting growth in other industrialized countries and easing the difficult adjustment problems of much of the developing world. At the same time, that progress has been accompanied by some obvious and serious imbalances in the international economy and financial system. Those international strains are a reflection, in considerable part, of problems in internal policy here and abroad.

One aspect of those problems that has received a great deal of attention, internationally as well as domestically, is the high level of interest rates in United States. Those interest rates have risen over recent months under the pressure of rising private credit demands, as the economy has grown, superimposed on the need to finance an already huge Federal deficit. High interest rates have helped attract a growing inflow of capital from abroad, and that inflow has, for the time being, helped to reconcile rising investment with the need to finance the deficit.

But the capital inflow is not without heavy cost to us and to others in the short and long run. The essential counterpart of a net capital inflow is a massive trade and current account deficit partly related to an appreciating dollar. Increases in our interest rates directly add to the strain on the external payments of heavily indebted developing countries. And, over time, the capital flows and trade imbalance will not be sustainable, posing the risk of further financial disturbances in the absence of needed policy adjustments.

If we are to restore better balance in our international trade accounts and relieve the pressures on our internationally exposed industries, and if we are to mitigate the burdens that high interest rates place on borrowing countries without undermining other objectives—including stability and growth at home—we cannot, in my judgment, escape the need for decisive action to reduce our Federal budget deficit. The more slowly we proceed in correcting our internal imbalance, the greater are the risks not only to our international trade position, but also to the health of our domestic economy and our financial markets.

Congress is in the process of taking a first step toward dealing with the problem over time, and I welcome that effort. Reducing a substantial budget deficit, in the United States as elsewhere, is not easy. Popular support for painful adjustment is particularly difficult to win when the consequences of inaction are prospective rather than immediate. That, to many, has appeared to be the case over the past year and a half as our economy has performed remarkably well. From the fourth quarter of 1982 through the first quarter of this year, our gross national product has expanded at an average annual rate of 6¾ percent in real terms, while the unemployment rate has declined from its 10¾-percent peak at the end of 1982 to 7½ percent in May. Moreover, the recovery has brought healthy rates of investment in producers' durable equipment, in nonresidential structures, and in housing.

Of course, these gains started from a low level, and for a time it could be argued that an expansionary thrust from the budget deficit could be helpful. But, as the forward momentum of the economy continues and private spending and borrowing increase, the consequences of the continuing structural budget deficit are apparent.

That is perhaps most apparent in the deterioration of our trade position. One counterpart to the continuing Federal budget deficit at a time of growing economic activity has been the growing net inflow of capital from abroad and its counterpart, the widening deficit in our current account transactions with other countries. In essence, that growing deficit has permitted us to consume, to invest, and to buy "more government" than provided by the increase in national output—the GNP. In fact, all domestic demands have expanded since the fourth quarter of 1982 at an annual rate of 8¾ percent, about 2 percentage points faster than our gross national product [GNP]. Looking at the financial side of the equation, the net inflow of capital that we have attracted from abroad is supplementing internal savings by about one quarter—or by more than 2 percent of the GNP—enabling us to finance our large Federal deficit while private spending on consumption and investment goods has also been growing rapidly.

Whatever the net benefits and difficulties of this process to date—and both have been present—the issue for the future is how to promote a sustainable pattern that meets our interests in stable and sustained growth at home to a context of growing world trade and financial stability. In analyzing these prospects, it is useful to review developments with respect to our external position since the fourth quarter of 1980, when the dollar began its extraordinary appreciation. From that period through the first quarter of this year, our trade balance has deteriorated by roughly $75 billion, despite a sizable reduction of about $25 billion in our imports of oil. The adverse swing in the nonoil trade balance has thus amounted to about $100 billion. To put that figure in perspective, the additional $100 billion annual sales that our tradable goods industries might have retained or captured in the absence of shifts in our nonoil trade flows is two-thirds the size of the entire annual output of our residential building section, which measures around $150 billion in the GNP accounts.

Plainly, the deterioration in our trade position has had profound effects spread through many firms and farms in all parts of the United States. Those engaged in foreign trade or competing with imports have not shared proportionately in the strong expansion of the U.S. economy, and some important industries are still operating well below 1980 levels. Exports of all major categories of goods have declined since the fourth quarter of 1980. Measured in real terms or at constant based-period prices, exports of agricultural goods declined by 4 percent on balance, while exports of nonagricultural goods declined about 15 percent. Among the leading categories of nonagricultural goods, exports of both machinery and industrial supplies declined nearly 20 percent. The longer our exports remain depressed, the more difficult it becomes to maintain marketing networks, and the more costly and difficult it becomes to recover foreign sales.

The strong expansion of aggregate demand in the United States relative to aggregate demand in foreign industrial economies has contributed importantly to the widening of our trade deficit. In that sense, some of the deterioration in our trade position is cyclical and reflects not the loss of markets at home or abroad, but rather the absence of proportionate gains. In addition, exports have dropped sharply to developing countries that are burdened with large external debts and are in the process of readjusting their economies and their balance-of-payments positions. This is particularly true with respect to our neighbors in Latin America; our exports to that area have dropped by $15 billion since the fourth quarter of 1980. Together, the change in our cyclical position relative to foreign industrial countries and the decline in our exports to debt-burdened developing countries appear to explain one-third to one-half of the adverse swing in our nonoil trade balance.

The dramatic appreciation of the dollar has also had an important effect. Since the fourth quarter of 1980 the value of the dollar has appreciated about 45 percent on average against the currencies of foreign industrial countries. Over the same period, U.S. price performance has been somewhat better than the average in foreign industrial economies, but even allowing for the differential in inflation, the dollar has appreciated substantially. No doubt that appre-

ciation of the dollar has helped to maintain the progress made against inflation during a period of vigorous recovery. But, if it proves inconsistent with a more sustainable trade position, we cannot count on the current strength of the dollar to persist indefinitely.

The dramatic appeciation of the dollar reflects a number of forces, and the outlook for the dollar is difficult to predict. Apart from the relatively high level of interest rates in the United States, the performance of our economy and a sense of confidence in our political stability have helped encourage capital inflows, particularly when tensions have increased abroad. The degree to which these forces will continue in the months and years ahead cannot, of course, be assessed with certainty, but the point is often made that, in a purchasing power sense, the dollar is now overvalued. Such calculations are necessarily imprecise. They differ depending upon the particular type of price index that is used—consumer prices, producer prices, export prices, et cetera—and upon the time period that is chosen as the base period for the calculations.

There can be no doubt, however, that the dollar has risen in recent years substantially more than in proportion to movements in relative price levels here and abroad. Thus, the value of the dollar is substantially higher today than would be warranted solely on the basis of changes in the relative levels of United States and foreign price indexes.

But exchange rates are clearly influenced—in the short and even in the longer run—by factors other than relative rates of general price inflation. This often is the case when there has been a substantial change in the relative levels of interest rates, as has been the case between the United States and its trading partners in recent years. In principle, large capital inflows could persist for some time ahead even though the United States is now becoming a net debtor internationally. But there is a serious question as to whether the situation is in our best interest or that of other countries. High interest rates pose severe problems for important sectors of the domestic economy and certainly for the indebted countries. Moreover the sustainability of our trade deficits and net capital inflows over a prolonged period are questionable, to say the least.

A precipitous large decline in the dollar, whatever its immediate cause, would not be in our interest. If related to a reduced willingness to invest in, or lend to, the United States, the burden of financing the budget deficit, in competition with private needs for credit, would be increased. Domestic prices and costs would be affected. And, the prospects for achieving lower interest rates would be further clouded.

All of that emphasizes the key importance of maintaining confidence in our economic policies and outlook. There are implications for monetary policy because that confidence must be rooted in a sense of conviction that inflation will remain under control. And there are clear consequences for fiscal policy as well because of understandable concerns that excessive fiscal stimulus may regenerate inflationary forces or stronger financial market pressures, or both.

There is a straightforward and constructive way to deal with concerns of the kind—a way fully consistent with purely domestic needs. I am thinking, of course, of credible action to put the structural budget deficit on a course that is headed toward balance within a reasonable time period. Apart from the direct benefits of taking pressures off financial markets and reversing recent increases in interest rates, we would become less dependent on inflows of capital from abroad to balance our savings with our investment needs. Over time, the dollar should move into an equilibrium consistent with a stronger, and sustainable, trade position. And, the risk of disturbingly large declines in the dollar should be ameliorated because U.S. policies would earn the continued respect and confidence of the financial community.

While I will not try to suggest an appropriate "equilibrium" value of the dollar over time, I do believe that balance will be struck at a higher level, and the risks of sharp and abrupt changes reduced, to the extent that we can build upon the progress against inflation. I also believe it is not in our interest to see abnormal, and ultimately temporary, strength in the dollar when such strength is really a reflection of imbalances in our domestic policies and markets.

Sometimes it is suggested that intervention in exchange markets can be useful to smooth these fluctuations, or as some would suggest now, to depress the dollar in the interests of our trade position.

In my judgment, exchange market intervention can play a useful role in dealing with disturbed market conditions or, occasionally, in signaling the desires or policy intent of the financial authorities in various countries, particularly when the approach is coordinated among them. But its role is subsidiary: experience strongly suggests that intervention alone is a limited tool that cannot, itself, greatly or for long change market exchange rates unless accompanied by changes in more basic policies. In present circumstances, as I have indicated, we have come to rely on inflows of capital to finance our domestic needs. So long as the fiscal situation is unchanged and private credit demands are high, an intervention approach that resulted directly or indirectly in curtailing that flow would risk undesirable consequences for interest rates. Those risks would be particularly great if the United States were seen to be embarking on a deliberate policy of depreciation.

Others suggest we attack our external deficits directly, either by erecting barriers to capital flows or by restricting imports. Again, such measures do not go to the root of the difficulty.

To the extent direct measures were successful in reducing the net capital inflow, real interest rates in the United States would presumably rise, other things equal, as part of the process of replacing the lost saving from abroad with an increase in private domestic saving or a reduction in private domestic investment. The burden of our budget deficit on interest-sensitive sectors of the U.S. economy would be intensified; the problem would be shifted without resolving it. That would be true quite apart from the other compelling considerations against direct controls, which would be administratively difficult and contrary to our basic interest in open markets.

Yielding to the pressures for intensified import restrictions also could only complicate our problems. Beware, in particular, of arguments suggesting that import restrictions designed to benefit one industry or another will produce more jobs for the economy as a whole. To an individual firm or industry, shutting off import competition offers immediate advantages; more generally, it is argued that each $1 billion of the trade deficit represents $1 billion of domestic output foregone, other things equal. Using the rule of thumb that each billion dollars' worth of domestic output requires about 25,000 workers, it is then calculated that 1 million jobs could be created by reducing the trade deficit by $40 billion.

The pitfalls in such reasoning should be clear at a time when the economy is already expanding strongly: a more rapid growth of output and employment than we have experienced over the past 1½ years, combined with reduced capital inflows, would likely have been reflected in more pressures on financial markets at the expense of other sectors of the economy.

More generally, it should not be ovelooked that the decision to protect one industry invariably imposes costs elsewhere. It is costly to other industries if foreign countries retaliate against U.S. exports, if import restrictions lead to higher dollar exchange rates than would otherwise prevail, or if costs rise. Protection typically leads also to higher prices and less choice for consumers and can be politically difficult to terminate, as exemplified by the current export restraint program on Japanese automobiles.

Still another essential reason for resisting protectionist pressures is the adverse implications of protection for the export earnings of the developing countries. We encourage those countries to take effective measures to build their productive structures over time, and we urge strong steps to adjust their economies in the short run to generate the payments due on their debts. But those processes cannot ultimately succeed if the United States and other industrial countries protect their own markets from the competitive exports of the developing countries.

Those developing countries have traditionally been an important market for our exports, and they have the potential to be much larger. That process of two-sided trade is fundamentally a healthy one—a process that raises our own average productivity and real income over time at the same time that it promotes growth in the developing countries. In a context of growing economies, we should be able to adjust to international competition so that we can ease the process of transition for impacted workers and firms.

That, of course, is more easily said than done. It is particularly difficult to anticipate adjustment and to accept the pressures of international competition in an environment of large and fairly rapid swings in exchange rates. Moving toward a healthier process of international development and competition over time requires that we discipline our fiscal and monetary policies to provide the conditions for more stable exchange rates.

This brings me back to the central thrust of my remarks—the need here and elsewhere to achieve better balance in our basic policies and a more sustainable pattern of external transactions.

Much has been achieved in these last few years to put the economy on a sounder footing—too much, at too great a cost, to see it all

jeopardized now. Our recovery has been proceeding rapidly, with little acceleration of inflation. But the combined credit demands of the Federal Government and the private sector have generated disturbing pressures on interest rates, on developing countries, and on exchange rates.

In concept, we can visualize an economic expansion characterized by relatively high interest rates and by strong private consumption and a large budget deficit. That is what we are having. But it has costs—costs reflected in huge trade deficits and net borrowing from abroad, potential problems for housing and other interest-sensitive sectors, and risks of exchange rate and financial instability.

What is at issue is the sustainability of growth here and abroad, and our prospects for further progress toward price stability. In the end, I know of no way to deal with these risks, and to provide solid assurance that we can build on the real progress of the past, other than to carry through on the efforts to deal with the Federal deficit.

Thank you, Senator.

Senator MATHIAS. Thank you very much, Chairman Volcker. We appreciate the very comprehensive statement that you have made. I think you have identified the important factors that affect the health of the world trading system and have given us some suggestions as to how they can be improved.

There is always a tendency in human affairs to want to point a finger at other people, to say that they are the cause of our difficulties. In this spectrum of factors that you have presented to us, can you differentiate between those that the U.S. Government can unilaterally control and those that are going to require some cooperation and action on the part of our trading partners and other nations around the world?

Chairman VOLCKER. Clearly the one that we can unilaterally control, that is our problem, so to speak, and directly within the ambit of Federal policy—you cannot look anywhere else for help—is the budget deficit. That is, I really think, the central issue.

There are counterpart problems to that abroad. Let me take the situation in Japan, for instance. We are all very envious, I think, of the high savings rate they have in Japan. They save about 20 percent of their gross national product. We save about 8 percent of ours.

Japan has a big trade surplus, running to $40 billion or so a year now. They have a big capital outflow. They have had less growth in recent years than they have been used to earlier.

I think that raises a question converse to our problem: are they having trouble utilizing their great capacity to save fully at home, and as their growth has slowed—still fairly healthy by our standards, but slower than they used to enjoy—are they using enough of their savings at home, or is that savings spilling out abroad? It keeps the yen relatively depressed considering the strength of their trade position. To what extent is that complicating this problem in an inverse way to our budget deficit and our lack of capacity to save at that rate?

You have continuing problems in the world trading system, to get a little bit away from the financial area, continuing problems that become greater during a period of sluggishness—problems

that we no longer have here but the rest of the world does, in terms of growth.

That causes problems in following what might be called fair trading practice rules; it leads to efforts to subsidize exports by one device or another or, conversely of course, to restrict imports. I think countries rather generally have maintained a degree of discipline, but there has been slippage here and elsewhere from the standards one would like to see observed over time.

You see that in foreign countries as well as here, and, obviously, that does call for an effort on the part of those countries as well as us to try to resist those pressures.

I would like to say, too, just in terms of action in a more general way, that as growth picks up abroad—and there are some signs that that is happening—that could be an important influence on our exports.

Senator MATHIAS. A favorable influence?

Chairman VOLCKER. A favorable influence, yes.

Senator MATHIAS. You put some emphasis in your statement on the question of capital inflow. As I understand the situation, the United States enjoys something like $850 billion of external assets and something on the order of $720 billion in external liabilities, so that we have a net balance of external assets of over $100 billion. My figures may not be precisely accurate, but I think they're within the general order of magnitude.

Chairman VOLCKER. To be precise, even if you are reciting the official figures correctly, because I do not think the official figures are precisely accurate——

Senator MATHIAS. Well, I am not sure that anybody really knows.

Chairman VOLCKER. I do not think anybody knows with that degree of precision.

Senator MATHIAS. We are now, I think, the proud possessors of something like $100, $120, $130 billion of net assets abroad. But at the rate that we are borrowing, at the rate that our net balance is declining, we will become a net debtor nation, as you suggested, certainly within 2 years and maybe in substantially less than 2 years.

Chairman VOLCKER. Yes. I think on those figures we become a net debtor next year. One of the largest items in this area is called statistical discrepancy, and if one uses another interpretation of the statistical discrepancy as reflecting debts, we are already, this year, moving into a large net debtor position, and very rapidly.

Senator MATHIAS. What does that mean in practical terms?

Chairman VOLCKER. It is a nice benchmark to cite, and I think it reflects the fact that things are moving very rapidly in an adverse direction. We built up a net creditor position over the entire postwar period, rather laboriously, year by year, and, as you point out, in 2 or 3 years it is all gone.

Other than a warning signal, crossing that line from net creditor to net debtor does not imply anything for the economy, in the immediate sense.

Senator MATHIAS. The lights are not going to go out.

Chairman VOLCKER. That is right. We are a big country and if we are a small debtor internationally nothing is going to happen. We can service that debt.

What is disturbing is the speed with which this is happening, and if it continues for very long then questions begin arising as to where we are going. First of all, that situation compounds upon itself. We have enjoyed a flow of earnings from this net creditor position. As we become a net debtor, the flow of earnings goes in the other direction and the deficit threatens to compound upon itself.

If the trade position did not change at all and we had to pay more and more interest every year, we would dig deeper into a hole. In an exaggerated form, that is what has been happening, or was happening, in Latin America, for instance.

You just cannot keep piling up debts, it seems to me, at that rate of speed every year without somebody at some point saying, "I do not think the United States is such a good place to put my money any more." And if that capital inflow is suddenly shut off and we have not done anything about the deficit, we are in trouble; we have to finance our deficit at home and we have to finance our investment at home, and where is the money going to come from?

We have, in a sense, become addicted to this flow of savings from abroad.

Senator MATHIAS. So that is one of the factors that you were referring to when you said that the sense of confidence that has encouraged lenders abroad——

Chairman VOLCKER. Precisely.

Senator MATHIAS [continuing]. To bring their money to the United States will be dissipated.

Chairman VOLCKER. That is right. At some point, the mere fact that we are borrowing so much will undercut that confidence.

Senator MATHIAS. And there is no way to pinpoint that moment in history.

Chairman VOLCKER. Not at all.

Senator MATHIAS. And probably the tragedy of it is that we will pass it before we will realize that it is on us.

Chairman VOLCKER. If you pass it before you take the obvious action to offset it, you are already in trouble. This can happen, unfortunately, with some suddenness, because it depends upon a change in psychological mood, a change in attitudes.

Senator MATHIAS. And then we would have the kind of precipitous drop in dollar values that you referred to.

Chairman VOLCKER. That is one important risk, yes, sir.

Senator MATHIAS. Let me yield at this point to Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Chairman Volcker, I am interested in the fact that the cyclical shifts are out of synchronization between ourselves and particularly the major industrial countries. But first of all, are you satisfied with the degree and level of consultation amongst finance ministers or economic officials amongst these nations to try to put those policies into the same cycle?

Chairman VOLCKER. There is a lot of consultation, as you know, a lot of conversation, a lot of contact among officials at the finance

ministry level, central banking level, and, as we have recently seen, at the head of state level.

I think that is useful in increasing understanding, mutual knowledge of each other's intentions and policies. In the end, it is not consultation that is going to produce the action, but action that produces action, if I may say so.

I think there are needs for some policy shifts. You say: "synchronizing the cycle." It is not always a good idea, in my judgment, to have the cycle perfectly synchronized around the world, but there are limits to discrepancies that can be easily tolerated.

Senator SARBANES. I take it your view, obviously, from this statement is that the high deficits at home do have an impact on the interest rates.

Chairman VOLCKER. I do not think there is any question of that, yes.

Senator SARBANES. Well, where are we on trying to integrate our policies with other countries when we have an international summit and the Secretary of our Treasury says there is no connection.

Chairman VOLCKER. I do not think I want to comment on statements at a summit that I did not attend.

Senator SARBANES. You would disagree with a statement that said that there was no connection between high deficits and high interest rates?

Chairman VOLCKER. Yes; I would disagree with that statement. But let me say, I think the way the deficit impacts on interest rates depends a great deal on the condition of the economy generally; and, as you know, we have had a pattern of a rapidly rising economy.

We have not got the excess capacity, excess resources, that we had even 1 year ago, and it is in those conditions where a deficit becomes particularly important. To state it another way, it is not the cyclical deficit that is so important. The deficit goes up in a recession.

We have a large underlying deficit, The so-called structural deficit, that would be with us in good times and bad times, of upward of $100 billion, and it is that deficit that is so difficult to finance on the upswing of a cycle.

Senator SARBANES. You also noted that the decline of exports to the debt-burdened developing countries accounts for part of this adverse swing in the trade balance. Given, I take it, that the austerity programs are a necessity, I assume that factor will continue to be a problem over a predictable period of time.

Chairman VOLCKER. It should not be a problem in the same way that it has been over these past 2 or 3 years, because we now have the most important countries, in Latin America in particular, at a stage of their adjustment where the really brutal cutbacks in imports are, I hope, behind us. We move into a phase when they can resume both internal growth and, related to that, import growth.

I think the problem is behind us in the case of Mexico, which had the most important influence; it is a neighbor, obviously, immediately to our south, where we have big trade relationships. Mexico had a decline in imports on the magnitude of 50 percent over a period of time, but now they are moving up again.

That $15 billion figure, which was importantly Mexico, is now behind us in the sense of a decline and it is beginning to move up, although it remains. Other countries are not as far along as Mexico. It is a continuing problem. It is just not a problem to the extent that it has been during this particular period, if these debt problems are successfully managed.

If we fail to manage the debt problems we could go through another round of difficulty for us and for them.

Senator SARBANES. Do you think as part of successfully managing the debt problems that, as some have suggested, there should be, if not a formal cap on interest rates on rescheduled LDC loans, greater consideration of restraint and adjustments in that area?

Chairman VOLCKER. I think that is one technique; there are other financial techniques, more innovative techniques, that are useful to look at. That is one of the techniques that I think would be useful, to see whether borrowers and lenders might find it to their mutual advantage.

I think in the end it is a question of the negotiation between the borrowers and the lenders, but having that on the table as something to be looked at makes some sense to me.

Senator SARBANES. How open would you say America's markets are as compared with the openness of foreign markets to America?

Chairman VOLCKER. It is very hard to judge. The instinct of Americans, I think, is that our markets are the most open among the large countries. That would be vigorously protested by some other countries like Germany, for instance, that has had, I think, a reasonable tradition of open markets.

You run into cases like Japan, where there is an appearance of markets being much less open, but I think there is a serious question as to how much that is due to official policy, and how much is due to cultural business practices that make it difficult for Western-oriented businesses to penetrate in the same way.

Broadly, I do not think we have anything to be ashamed of in the openness of our markets on a relative basis. Having said that, I think there has been some backsliding in the United States, as elsewhere, in recent years.

Senator SARBANES. Thank you.

Thank you, Mr. Chairman.

Senator MATHIAS. You have said, and I certainly agree with you, that budget deficits are a major factor in interest rates. But I have to confess that I am somewhat confused by some aspects of the current situation.

We have budget deficits that are currently running in the neighborhood of $200 billion.

Chairman VOLCKER. It will be less than that this year, I think, with the recovery of the economy. But the threat is that they will be——

Senator MATHIAS. Not too much less.

Chairman VOLCKER. Not too much less, no.

Senator MATHIAS. Alice Rivlin has projected a budget deficit by 1986 of $300 billion—that is, of course, in the absence of some corrective steps—and a budget deficit by 1988 of $400 billion. These are pretty sobering figures even if they are off.

Chairman VOLCKER. I have not seen that particular set of estimates. That is the most pessimistic set I have heard of. But, as you say, they could be off by a factor of 25 percent or more, and it would still be a distressing picture.

Senator MATHIAS. Well, she makes a very strong case for that gloomy outlook.

Chairman VOLCKER. Let me put the deficit picture in this kind of perspective. It may illustrate the point of the difficulty of these forecasts, and also the horrendous nature of the deficit. I have been in and out of this business of looking at Government financial policies and deficits for 25 years now, I suppose.

I do not know of any other time when one looked ahead over a 5- to 10-year period and worried about the compounding effects of interest on a deficit currently being incurred. But when these deficits are so big—they run in the neighborhood of $200 billion—the payment of interest on that $200 billion the following year becomes an important factor in next year's deficit; and if you go out 3 or 4 years it becomes a very large factor.

You can get quite different budget estimates for 1990, let us say, or 1988 simply depending upon what interest rate estimate you make. If you put in a little bit higher interest rate estimate, the thing begins exploding on you. You get that kind of a figure when the basic deficit is so large to start with. We have just never been in this position before.

Senator MATHIAS. How do you interpret, in the light of that uncertainty, the fact that in the last few weeks short-term interest rates seem to have been edging up, but the long-term Treasury rates have gone down by about a point? What are the conflicting factors?

Chairman VOLCKER. I do not think the long-term Treasury rates have gone down by a point. They have gone down some following a very sharp increase in long-term markets.

I say "very sharp" because normally long-term rates move more sluggishly than short-term rates. We had a peculiar situation in the past 2 or 3 months where long-term Treasury rates were going up more rapidly than short-term rates; I think they reached something like 13¾ percent or close to 14 percent at one point.

After that distressing decline in prices or increase in interest rates, we have had some recovery in recent weeks, but the recovery has been nowhere the size of the decline. Markets move in spurts, as you know, in either direction, as attitudes or particular developments emerge or change.

This was a period of very heavy Treasury financing, following both the reality and the appreciation of rapid growth in the economy and large increases in private credit demands over roughly the first 4 months of the year. Those factors impinging upon each other, generating concerns about the possibility of inflation rising in the future, generating concerns about the continuing shortfall of domestic savings relative to demand, had both an immediate supply/demand effect on the market and an expectational effect on the market in a depressing direction. Now we have had a partial reversal of that.

Senator MATHIAS. You have talked about the need for a budget deficit reduction effort in terms of a $50 billion cut in the deficit in

fiscal year 1985, or at least you have been so quoted. What sort of mix of effort would you recommend for achieving that?

Chairman VOLCKER. In this area, I think I would be infringing upon your prerogatives to get very specific about the kind of social program decisions that need to be made.

Senator MATHIAS. I do not think it is a question of infringing upon our prerogatives. I think we need help.

Chairman VOLCKER. I do think it raises questions of social priorities, national security priorities, programmatic priorities, that I do not have either any expertise or general competence in. But let me say, in general terms, purely from an economic standpoint, from the standpoint of what way the general economy will best function, the more the deficit can be closed on the expenditure side the better.

I would also say, as a practical matter if, for whatever reason, that does not prove possible and you cannot do the whole thing on that side, the importance of this issue is so great that you have to look at the revenue side, too.

Senator MATHIAS. In plain English, that means raising taxes.

Chairman VOLCKER. I was going to say that means t-a-x, yes.

Senator MATHIAS. I agree with you. I think it is unavoidable, and as painful and as difficult as it will be, I think it is in the long run less painful and less difficult than not doing it.

Chairman VOLCKER. You have a very difficult task in making the necessary decisions. I was struck very much with a poll that I saw—this is no news to you; it is no news to any of us, but I will just put it in statistical terms—a newspaper a couple of months ago reported a survey in which a cross-section of the public was asked three questions.

First, do you like the deficit? Is the deficit an important problem? Of course, an overwhelming number said yes. Second, they said, would you agree to an increase in taxes to reduce the deficit? Three out of four said no. Third, they asked, would you agree to a reduction in expenditures to reduce the deficit? Two out of three said no, which did not leave very many alternatives that I saw. [Laughter.]

But I think the answer to the first question was right, that the deficit is an enormous problem and it has to be dealt with.

Senator MATHIAS. Thank you.

Senator Sarbanes.

Senator SARBANES. Mr. Chairman, would you say that the essential flaw in the current economic policy is the fact that we are on expenditure and revenue trend lines that would still leave us with a large deficit even if we were at full employment levels?

Chairman VOLCKER. Yes.

Senator SARBANES. In your statement you said "a precipitous large decline in the dollar," and I wonder what the range of a precipitous large decline is.

Chairman VOLCKER. I do not know. It is partly a psychological question as to whether you had a decline in the dollar. It depends upon the origin of it, whether it reflected declining confidence, which you clearly would not want to see, and whether it was of a nature to feed upon itself, with the decline in the dollar generating further declines because people expected it to go down further.

I think that is the kind of situation we would like to avoid. That is quite different, in fact, in its impact—and not just its psychological impact—I think, than if a decline developed over a period of time, irregularly, more gradually, and did not reflect a sense of, "Let us get out of the dollar."

Senator SARBANES. The traditional theory is that the valuation of your currency will be affected by the trade terms and will be self-correcting over time.

Chairman VOLCKER. Right.

Senator SARBANES. I take it that is really being short-circuited to some extent at least by the capital movements?

Chairman VOLCKER. That is correct.

Senator SARBANES. Do you think we need some new Bretton Woods conference to address that problem? I do not see how we get out of this appreciated currency problem that we are confronting.

Part of the large trade deficit results from that, and yet the self-correcting mechanisms do not work because of the capital movements which cut across it. So we do not get the adjustments.

Chairman VOLCKER. Those self-correcting mechanisms I think will work. It is a question of when they work, how abruptly they will work; if they are delayed too long, they will be disturbing in and of themselves.

I think I would have to respond to your question by saying we are not going to resolve it by conference or consultation. You are going to solve it by action, and the action has to be to attack the policies that underlie the problem.

I do not want to decry the idea of changes in the international monetary system. That can be important for other reasons over a period of time, particularly attacking instability in exchange rates. Certain kinds of international monetary systems might imply more discipline on domestic policies here or elsewhere.

But again, in terms of our particular problem, I think you have to look to action rather than to a reconstructed system.

Senator SARBANES. Thank you.

Thank you, Mr. Chairman.

Senator MATHIAS. You mentioned at some length the impact of the world debt problem on our trade difficulties. It seems like a long distance from the Baltimore Harbor to Rio de Janeiro or to Buenos Aires, and I think it is very difficult for a great many people to connect the financial problems in those two cities with the loss of jobs in Baltimore.

Chairman VOLCKER. I would hope it is easier here. I do not know just where all the ships in Baltimore Harbor go to or where trade from this particular locale goes, but we have a lot of exports to those countries. We used to have more.

Senator MATHIAS. We have a substantial volume from Baltimore to South America.

Chairman VOLCKER. I would think that you have a substantial volume from Baltimore to South America, and you probably have a substantial volume in the other direction as well. I guess you used to get a lot of iron ore to run the steel mills in Baltimore from South America or elsewhere.

Senator MATHIAS. Unhappily, there is less activity in that area.

Chairman VOLCKER. There is less activity in the steel mills, so there is less import of the ore, I suppose. But this, of all cities, is a center. That may be several thousand miles away, but it is not very far away in terms of trade flows; it is right here.

Senator MATHIAS. The fact is that in recent months there have been hunger strikes, hunger protests in Sao Paolo, Brazil. The Argentinians are restless under the program that has been outlined by the International Monetary Fund [IMF]. The whole world debt problem is far from solved.

Can you give us your general feeling about where the world debt problem is going and how that is going to relate to cities like Baltimore?

Chairman VOLCKER. I think you are correct that it has not been solved. I would guard against undue euphoria because some event has passed or milestone has passed when the initial Mexican thing was taken care of. The underlying problems of Latin America have not been solved.

However, I also want to guard against undue pessimism. I think that problem can be managed, but it is going to have to continue to be managed over a period certainly of several years yet. One of the threats is that energy flags when so many people are involved in so many difficult, almost continuous, negotiations, and we have to guard against that kind of letdown.

In some areas, I think it is fair to say that we are moving into a new and more constructive stage. As I indicated earlier, the brunt of the export decline I think is over, and indeed our exports to some of these countries ought to be improving.

Why? Because their domestic situation is bottoming out and because their external finances are now in significantly better shape than they were a couple of years ago. Mexico is running a surplus now in its payments. They will not, from all indications, need any net new money next year from the banks.

They still have a major refinancing job to do. The banks have undertaken to discuss this with Mexico in recent days, and it offers the prospect of a substantial stabilization of their position, of moving ahead; it offers a promise of moving out of any crisis phase with respect to Mexico. That probably is the furthest advanced country. I think it is the furthest advanced country, major country, in this adjustment program.

But there are some favorable signs, for instance, in Brazil, where their external performance, their exports have been better than projected. There are indications of some growth in the economy now, led by exports. Their growth is going to have to be led by exports if they are going to be successful in servicing their debts and maintaining growth. Their domestic economy is still under heavy pressure, but on balance it seems to be growing a bit because the export sector is so strong.

A country like Venezuela has a less severe underlying problem because of its oil exports, but it still has a problem. I think it can move to a stage of stabilization over a period of time.

You mentioned Argentina. I think Argentina is in a different situation, where the same progress has not been made. It is not over the hump either internally or with respect to dealing with the external debt problem.

Senator MATHIAS. Your colleague Tony Solomon has suggested that the banks ought to show more sensitivity and should reduce the level of interest rates in connection with debt restructuring arrangements with debtor countries, or at least he is so quoted in the press.

Chairman VOLCKER. I am not sure he said quite that. He may have said something about sensitivity, which is always important. He did throw out the suggestion of the interest rate cap, as Senator Sarbanes mentioned, and I think looking at techniques of that sort is useful and potentially important.

I do think that the creditors need to examine whether it is not in their own interest, particularly where there is progress, to put the finances on a sounder footing over a period of time; that, in effect, is what they said they were going to look at in the case of Mexico.

Senator MATHIAS. Of course, Senator Sarbanes and I have been subjected to the views of some of the Argentinian visitors that have been coming to see the Committee on Foreign Relations, who want the U.S. Government to take some kind of action to reduce the level of interest rates.

That would seem to me to be a very difficult kind of operation.

Chairman VOLCKER. The one constructive action you could take—and you would expect me to say this; I would be delighted—is to reduce interest rates, not simply for these borrowers, but for American borrowers. And how do you do that? You do that by reducing the deficit.

Senator MATHIAS. You are back to raising taxes again.

Chairman VOLCKER. I would prefer to cut expenditures. But we are back to doing something about the deficit again. Whenever we go around the circle of this problem, we will come to that at the center of it.

Senator SARBANES. What about the Secretary of Treasury, our chief financing official, subscribing to that point of view? That would be a helpful starter as well.

Senator MATHIAS. I do not believe Mr. Volcker is going to respond to that.

Chairman VOLCKER. That is right, I am not. [Laughter.]

Senator MATHIAS. You mentioned Argentina as a difficult case, and clearly it is. It has not made its peace with the IMF. It has not been able to satisfy the debt demands that are made upon it.

Suppose they do not reach an agreement. What kind of impact is that going to have on our financial picture?

Chairman VOLCKER. You know, you put it in the context of reaching an agreement with the debtors, making peace with the IMF. But the most fundamental thing that the Argentine Government has to do in my opinion—as these other governments have to do—is make peace with themselves in terms of an economic program that is going to lay some kind of base for the longer term growth of the country.

Argentina has an inflation rate which is hard to calculate it is so high. It fluctuates a little from month to month, but let us say 500 percent a year and rising, maybe 700 percent a year. They have had inadequate economic performance at home for a number of years. They have had enormous capital flight for a number of

years. A large portion of the domestic savings of Argentina has been going abroad.

As with any other country, I think the primary criterion they have to meet is to develop an economic program that stabilizes their own situation, provides confidence for their own citizens, permits them to utilize their own savings at home. All those things will relieve pressure on the external debt situation.

Now, how do they achieve that? That is what the argument should be all about.

Senator MATHIAS. I have just one further question. In your statement you said that in your judgment, exchange market intervention can play a useful role in dealing with disturbed market conditions or occasionally in signaling the desires or policy intent of financial authorities.

I think this is an interesting area. I would agree with you that intervention has a limited role, but that may be an important role and there ought to be a capacity to do it on those rare and limited occasions.

Chairman VOLCKER. I agree with that.

Senator MATHIAS. Do we have an adequate capacity?

Chairman VOLCKER. Yes. If we want to do it, yes, we have the capacity in the Federal Reserve and in the Treasury.

Senator MATHIAS. You do not think the Congress needs to take any further action?

Chairman VOLCKER. No; I think we have adequate capacity. It is a matter of policy decisions, not technical capacity. We do not have all that many foreign currencies in portfolio. Beyond a certain point, if we were intervening on that side of the market we would have to borrow them. But we have some capacity to borrow them if we have to.

I would be a little happier, frankly, if we had more in our portfolios so we did not have to go through the process of borrowing them, but I think basically we have the capacity.

Senator MATHIAS. Obviously, you cannot enter the global exchange market and deal with all the currencies of the world. What would you think, five or six would be about as many as you would need?

Chairman VOLCKER. I do not think ordinarily you would need that many. There may be special occasions upon which you might need that many. But there are certain more or less key currencies that affect the tone of the whole market and the direction of the whole market: the German mark, the Japanese yen, perhaps the pound sterling, upon occasion.

You could have problems in an individual country abroad, an important country, where it might be useful to intervene in their currency. But, as a general matter, you are talking about two or three currencies.

Senator MATHIAS. But when we look at trade problems, when we look at the idle plant capacity that we have right here in Baltimore, exchange rates are one of the basic difficulties.

Chairman VOLCKER. Yes. But the box we are in, to repeat, is like this: if you could dream up some action—say suddenly change the exchange rate, or change the trade balance or some other action—such that the trade balance went from a $100 billion plus deficit to

zero, if you could imagine that, you would immediately be faced with the question of $100 billion in productive demands put back in the U.S. economy and $100 billion of capital inflow foregone.

How are we going to substitute for that capital inflow in financing our domestic development? If you do not do anything, somebody is going to get squeezed. Again, you come back to the same answer: you can make room for that by reducing the budget deficit. That is the constructive way to handle it.

In fact, if you reduce the budget deficit I think the other part will tend to fall into place. If you do not reduce the budget deficit, then you have to figure out some way to finance $100 billion more in the American economy. How you are going to do that?

I am afraid it is not going to be done to any large degree by additional finance. It is going to be done by squeezing out demands for that finance, and that, of course, implies pressure on financial markets and on interest rates, if nothing else happens.

Senator MATHIAS. I do not want to end your visit to Baltimore on a pessimistic note. What are you suggesting?

Chairman VOLCKER. I am suggesting that you move just as rapidly as you can to make way for that otherwise constructive development by reducing the demands on our domestic market. I am sorry to sound like a broken record, but the only way I know of doing that is by reducing the budget deficit.

Senator MATHIAS. I hear you very clearly, and what you are saying is that we will have all the adverse effects of having wiped out the trade deficit without whatever benefits might ensue.

Chairman VOLCKER. I suppose you will get some benefits for the people in our export trade industries, but what I am arguing just as strongly as I can is the apparent desirability of reducing the budget deficit, as long as that underlying budget imbalance remains, action to reduce the trade deficit would just be pushing the problem back on another sector of the economy.

Senator MATHIAS. On that sober note, we will thank you for coming to Baltimore and thank you for your testimony today.

Chairman VOLCKER. Thank you. I was delighted to be here.

Senator MATHIAS. Chairman Volcker will be succeeded by a panel of witnesses who will address the issues of the adequacy and viability of the international trading system and of U.S. efforts to work within the system. We are grateful to all of them for being with us today.

We owe a special debt to the General Accounting Office [GAO] because, under the direction of Mr. Allan Mendelowitz, who will be one of the witnesses on this panel, the GAO is preparing a study of this subject. Several members of the GAO staff have made herculean efforts traveling, researching and writing to accelerate the first stage of this study and to make it possible for us today to benefit from the initial findings of the study.

I want to recognize Mr. Curtis Turnbow, the project director, Mrs. Margaret McGregor, the project manager, and Catherine Schinasi, the deputy project manager, who have come to Baltimore with Mr. Mendelowitz.

The other witnesses, David Rohr, who is the recently appointed International Trade Commissioner, Bob Lighthizer, a veteran of the Senate and Deputy U.S. Trade Representative, and Olin Weth-

ington, the Deputy Under Secretary of Commerce, if they will come to the witness table.

[Pause.]

Senator MATHIAS. I am advised that Mr. Geza Feketekuty is pinch-hitting for Mr. Lighthizer, so we are glad to have him here today.

Mr. Mendelowitz, would you lead off.

STATEMENT OF ALLAN I. MENDELOWITZ, ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE

Mr. MENDELOWITZ. Thank you very much, Mr. Chairman. I have submitted a fairly long statement for the record and, with your permission, I would be happy to read a short summary.

Senator MATHIAS. Without objection, your full statement will be included in the record and you can summarize it as you see fit.

Mr. MENDELOWITZ. Thank you.

We are very happy to be here today in this vibrant and exciting city of Baltimore to discuss some of the preliminary information we have compiled on our work relating to international rules governing trade, a study which we have begun at your request.

As you know, the basic objectives of this study are to analyze international trade practices and the discipline provided by multilateral and bilateral arrangements to cope with barriers to competitive trade. This work also builds on our past and ongoing work in the trading system, which includes reviews of the Tokyo Round, non-tariff barrier codes, and sectoral studies.

In the aftermath of the tariff and trade wars of the 1930's and the economic devastation of the Second World War, international leaders recognized the need to develop an international framework through which gradual liberalization of trade could be realized and trade frictions discussed and resolved.

The outcome of these discussions was the General Agreement on Tariffs and Trade, known as the GATT. There are currently 88 contracting parties to the GATT. The trade discipline of the GATT is based on several key concepts, including that of the most-favored-nation [MFN] principle, or nondiscrimination, national treatment, minimum protection, transparency, and dispute settlement through consultations.

The most-favored-nation concept essentially states that the contracting parties will conduct their commercial relations with each other on the general basis of nondiscrimination. National treatment implies that foreign firms should be treated on the same basis as domestic firms involved in the same activities.

The GATT does recognize the use of tariffs and sees them as the preferred mechanism of protection if it is needed, and encourages contracting parties to ensure that such measures are kept to a minimum level to avoid serious distortions to trade. The concept of transparency implies that a contracting party's regulations and procedures are open and unambiguous.

And finally, bilateral and multilateral consultations are encouraged as a means to settle disputes. The GATT is also the only mul-

tilateral trade organization with a formal dispute settlement process.

From its inception in 1947 through the early 1970's, the GATT framework has achieved remarkable success in reducing tariff barriers to trade. In addition, it has also attempted to reduce nontariff barriers. Since the late 1970's, however, the increasing use of protectionism in a number of different forms has raised questions about the continued viability of the GATT principles and structure.

Our current study is intended to clarify the trade practices employed by individual countries and the applicability of multilateral and bilateral agreements to these practices. We will be looking, for example, in the service sector at the telecommunications industry, in the agricultural sector at wheat, and with regard to the issue of safeguards, the steel industry. To illustrate the scope of recent bilateral agreements, we have chosen Brazil as a case study.

Trade in services is becoming increasingly important in the world economy. The service sector as defined by the United States consists of economic outputs which are not tangible goods or structures, including, but not limited to, transportation, retail and wholesale trade, advertising, construction, design and engineering, finance, insurance, real estate, professional services, entertainment, tourism, telecommunications, and overseas investment associated with the export and sales of such services.

Telecommunications is one of the largest and fastest growing areas of world trade in services, with a worldwide market for telecommunications and services estimated at $45 billion annually and forecasts that the market could grow to $90 billion in 5 years.

Barriers to trade in services may take many forms. They may include investment performance requirements, exclusionary import policies, discriminatory treatment of foreign versus domestic firms, discriminatory government procurement, and government monopolies. The barriers may reflect economic concerns, such as a desire to foster the development of a national industry, or noneconomic concerns, such as national security or issues of individual privacy. The regulation of domestic service industries for domestic policy reasons can have a major inhibiting effect on trade.

Generally speaking, the provisions of the GATT are understood to cover trade in goods, not services. However, because of the importance of trade and especially the importance of trade in services to the United States, the GATT Ministerial meeting in 1982 had placed before it by the United States a proposal to consider discussions within the GATT on service sector trade.

Both developed and developing countries expressed significant reservations about this proposal. One problem, for example, is that each service industry has its own set of characteristics and concerns. As a result, it is unclear how general trade principles can be applied to all service industries. Other problems include the importance of domestic policy objectives which can conflict with free trade and the existence of national telecommunications monopolies.

Many of the problems in agricultural trade result from policy decisions by countries in support of important domestic objectives. These include the price of food, self-sufficiency and security of supply, and raising the income levels of farmers. As a result, do-

mestic policy objectives tend to override trade considerations, making negotiations in the agricultural area very difficult.

At the GATT's inception, the United States supported special and differential treatment for agricultural products. GATT articles exempt trade in primary products—GATT refers to primary products specifically, not to agriculture—from some of the disciplines applied to trade in manufactured goods.

The special treatment provided by the GATT reflects U.S. concerns at the time. More recently, however, the United States has been in the forefront of those pushing for reform. Disputes center around such issues as what is an equitable share of world export markets and what is a primary product.

Attempts to deal with agricultural trade issues are continuing. The GATT is currently engaged in an exercise to have countries identify all subsidy and trade-related practices in their agricultural sectors. A similar effort is underway in the OECD.

There are also some discussions underway in these forums on possibly establishing new rules of appropriate behavior in agricultural trade, in an attempt to bypass and, therefore, solve current differences in interpretation of existing GATT rules. Despite these efforts, it is questionable whether an agreement to substantially liberalize agricultural trade can be concluded in the near future. The reality of large and politically influential farm sectors in many countries limits room for negotiation.

The GATT safeguard provisions are designed for the most part to deal with emergency situations in which import surges injure or threaten to injure domestic industry. Imports are permitted to be restricted for what is understood to be a temporary period, and countries whose products are restricted are entitled to compensation.

Despite the existence of the GATT safeguard provisions, an increasing number of trade-restricting agreements have been negotiated outside of the GATT rules, particularly article XIX, the safeguards provision of the GATT. Sector arrangements limiting competition are in place in a number of mature industries, especially those with significant emplcyment, including textiles and apparel—the multifiber arrangement—autos—the United States-Japan voluntary restraint agreement and the European Community-Japan agreement—and steel—the United States-European Community voluntary restraint agreement on carbon steel; and the European Community's 14 bilateral arrangements limiting imports of steel from various countries.

If we look at these industries, I think what we see is that the problems often go beyond trade issues. That is, the problems in these industries covered by such agreements very often are structural.

One criticism of these actions is that they tend to protect declining or inefficient industries, without ensuring genuine adjustment. Furthermore, such actions also tend to lead to trade diversion, that is, goods are diverted from the restricted market and flood other, still open markets. These trade-distorting effects are of concern to both developed and developing countries.

During the Tokyo Round of the multilateral trade negotiations, there was an unsuccessful attempt to negotiate an elaboration of

article XIX in the form of a safeguards code. Several critical features of the proposed code were not resolved, including (1) whether an action should be applied to the exports of a limited number of countries or to all exporters; (2) how to determine what constitutes injury; (3) the proper role of domestic adjustment mechanisms used in tandem with import restrictions; and (4) whether there is a need for preferential treatment for developing countries.

The 1982 GATT ministerial work program called for the development of a comprehensive understanding on a more efficient safeguards system. Although some countries' positions have moved closer to agreement in the intervening time period, progress toward reaching formal agreement has been very slow.

Further discussions in the international arena on appropriate safeguards actions and procedures may likely focus on: (1) limits on the types and conditions of unilateral actions which countries take and efforts to try to ensure the protection of competitive industries is temporary; or (2) requirements that such trade action will be accompanied by domestic programs that have genuine industry adjustment as their goal.

There is as yet no apparent consensus on these issues. In general, these problems reflect the wide divergence of views on the appropriate role of government in industry decisionmaking.

In addition to the three issues we will be looking at, we are also examining the rise of bilateral trade arrangements and resulting trade issues from the perspective of one country, Brazil, and looking at the new forms of export competition practiced by U.S. trade competitors. The bilateral trade practices we have identified so far as important or emerging competitive factors in exporting in our case study include: (1) exclusionary government-to-government agreements; (2) financing practices such as countertrade, bilateral clearing accounts, and export credits at below-market interest rates; and (3) compliance with trade-related investment performance requirements, such as technology transfer and export obligations.

For the most part, these practices are not covered by existing multilateral trading rules.

As a final observation, I would like to stress again that the issues facing trade negotiators today are highly contentious, primarily because they involve discussions of issues which heretofore have been primarily within the realm of domestic policymaking. The increased interdependence of countries in the last decade has made it more and more difficult to ignore the international consequences of domestic policy decisions.

That most of these decisions are taken in response to important domestic concerns in no way limits their impact on the international arena. U.S. trade negotiators are currently discussing the need for an agenda of a new round of multilateral trade negotiations. The impetus behind these discussions is a concern that the liberalization process achieved in previous GATT rounds is threatened by the recent increase in trade restrictions.

The general premise that discussions in the GATT and the OECD on current trade problems should continue is widely held. However, the necessary preparation for a new round of formal negotia-

tions, which would include the problems surrounding issues such as safeguards, services, and agricultural trade, is substantial.

A consensus on key underlying principles needs to be reached before formal negotiations begin. Without such a consensus, it would be difficult to conduct constructive negotiations and the likelihood of concluding a meaningful agreement would be reduced. Inadequate preparation for a new round of multilateral trade negotiations could result in failed negotiations and have serious implications for the trading system.

Mr. Chairman, this concludes my summary and, of course, I will be happy to try to answer any questions you may have.

[Mr. Mendelowitz' prepared statement follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

STATEMENT OF

ALLAN I. MENDELOWITZ

ASSOCIATE DIRECTOR, NATIONAL SECURITY AND

INTERNATIONAL AFFAIRS DIVISION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY

SENATE COMMITTEE ON FOREIGN RELATIONS

ON

INTERNATIONAL RULES GOVERNING TRADE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the preliminary information we have compiled in our work related to the international rules governing trade, a study we have begun at your request. As you know the basic objectives of this study are to analyze international trade practices and the discipline provided by multilateral and bilateral arrangements to cope with barriers to competitive trade. This work also builds on our past and ongoing work on the trading system which includes reviews of the Tokyo Round non-tariff barrier codes and sectoral studies.

In the aftermath of the tariff and trade wars of the 1930s and the economic devastation of World War II, international leaders recognized the need to develop an international framework through which gradual liberalization of trade could be realized and trade frictions discussed and resolved. The outcome of these discussions was the General Agreement on Tariffs and Trade (GATT). There are currently 88 contracting parties to the GATT. The trade discipline of the GATT is based on several key concepts, including that of the most favored nation principle or non-discrimination, national treatment, minimum protection, transparency, and dispute settlement through consultations.

The most favored nation concept essentially states that contracting parties will conduct their commercial relations with each other on the general basis of non-discrimination. National treatment implies that foreign firms should be treated on the

same basis as domestic firms involved in the same activities. The GATT recognizes the use of tariffs as the preferable mechanism of protection and encourages contracting parties to ensure that such measures are kept at a minimum level to avoid serious distortions to trade. The concept of transparency implies that a contracting party's regulations and procedures are open and unambiguous. Finally, bilateral and multilateral consultations are encouraged as the means to settle disputes. The GATT is also the only multilateral trade organization with a formal dispute settlement process.

From its inception in 1947 through the early 1970s, the GATT framework has achieved remarkable success in reducing tariff barriers to trade. It has also attempted to reduce nontariff barriers. Since the late 1970s, however, the increasing use of protectionism in a number of different forms, has raised questions about the continued viability of the GATT principles and structure.

Our current study is intended to clarify the trade practices employed by individual countries and the applicability of multilateral and bilateral agreements to these practices. In the services sector, we are looking at the telecommunications industry, in the agricultural sector, wheat, and for safeguard issues, steel. To illustrate the scope of recent bilateral agreements, we have chosen Brazil as a case study.

Trade in services is becoming increasingly important in the world economy. The service sector, as defined by the United

States, consists of economic outputs which are not tangible goods or structures, including, but not limited to transportation, retail and wholesale trade, advertising, construction, design and engineering, utilities, finance, insurance, real estate, professional services, entertainment and tourism, telecommunications, and overseas investment associated with the export and sales of such services.

Telecommunications is one of the largest and fastest growing areas of world trade in services. The world-wide market for telecommunications equipment and services is estimated at $45 billion to $50 billion annually, with forecasts that the market could grow to $90 billion in 5 years. Accurate estimates of the totals and comparison of country data are difficult because of definitional problems and the manner in which services are included in balance of payments statistics.

Agriculture has long been an area of extensive government involvement through subsidies and quantitative restrictions on trade. At the GATT's inception, the United States supported special and differential treatment for agricultural products. The variety of exclusions, waivers and other special treatment provided by the GATT reflect U.S. concerns at that time. More recently, however, the United States has been in the forefront of those pushing for reforms. The dispute settlement process has been used extensively and has provided a forum for discussion of many of the problems in agricultural trade.

Each agricultural commodity presents its own unique trade problems. We have chosen wheat as a commodity for study because (1) its production and export are important to the United States, (2) a relatively large amount of world production is traded, and (3) a relatively large number of countries participate in the wheat market.

An increasing number of trade restricting agreements have been negotiated outside the GATT rules, particularly Article XIX, the safeguard provision of the GATT. Sector arrangements limiting competition are in place for a number of mature industries including textiles and apparel (the Multi-Fiber Arrangement), autos (US/Japan voluntary restraint agreement--VRA, European Community/Japan arrangements), steel (US/European Community voluntary restraint agreement on carbon steel and the European Community's 14 bilateral arrangements limiting imports of steel from various countries), and footwear. These actions are intended to protect industries subject to severe competitive pressures, and for some industries, it is hoped that necessary investment and structural changes will take place to make these industries more competitive. One criticism of these actions is that they tend to protect declining or inefficient industries. Furthermore, such actions also lead to trade diversion--i.e.--goods are diverted from the restricted market and flood open markets. These trade distorting effects are of concern to developed and developing countries alike.

Steel making is viewed as important by both developed and developing countries. Developing countries have invested heavily in steel making facilities. The steel sector in much of the developed world is an example of a mature industry affected by slowed demand and competition from newly industrializing countries. Additionally, the steel industry, as is true for other mature industries, is politically significant in developed countries because of its employment levels. Thus, support for protecting domestic steel-making capacity has been strong. A significant number of import restraint actions have been taken to protect domestic steel interests in developed countries.

While recent government actions in each of the above areas have been motivated by important domestic objectives, they are viewed with increasing concern because of their effect on trade. At the heart of these trade concerns is the extent to which such actions are undermining the trading system that has served us well in the postwar period. Because the principles and structure of the trading system are at variance with many of the actions undertaken in response to important domestic objectives, negotiations in these areas are likely to be very difficult. The fact that the United States and some of its trading partners are at odds over the appropriate role of the government in the economy, makes the definition of problems and their resolution all the more difficult.

In the following discussion, we describe some of the current trade problems and explain the difficulties that are likely

to confront negotiators attempting to deal with them in any new round of multilateral trade negotiations.

SERVICES: A GROWTH INDUSTRY NOT COVERED BY THE GATT

Generally speaking, provisions of the GATT are understood to cover trade in goods. At the 1982 GATT Ministerial meeting, however, the United States proposed that the contracting parties consider discussions within the GATT on service sector trade. Both developed and developing countries expressed significant reservations about this proposal. One problem is that each service industry has its own set of characteristics and concerns. It is unclear how general trade principles can be applied to all service industries. Countries expressed concerns that basic GATT principles such as national treatment and nondiscrimination might not be desirable as disciplines for service trade, at least not without some revisions. The view was also expressed that it was not readily evident what benefits would accrue from such discussions or a potential agreement on service sector trade. Despite these reactions, the United States obtained agreement that contracting parties with an interest in services would undertake national studies of the issues in that sector. Some countries have submitted studies to the GATT and discussion on them has begun.

To date, the most comprehensive coverage of the service sector trade issue has been in the Organization for Economic Cooperation and Development (OECD). Specifically, member states of the OECD have agreed to three non-binding codes which have applicability to services.

1. The Code on Liberalization of Current Invisibles Operations calls for a halt in new restrictions on trade in services.

2. The Code on Liberalization of Capital Movements contains similar provisions for liberalizing foreign investment in service and other industries.

3. The Declaration on International Investment and Multinational Enterprise provides for national treatment in these areas.

In addition, OECD conventions of 1980 and 1981 pledge signatories to reduce and abolish obstacles to the exchange of goods and services.

Barriers to Trade in Services

Barriers to trade in services may take many forms. They may include investment performance requirements, exclusionary import policies, discriminatory treatment of foreign versus domestic firms, discriminatory government procurement, and government monopolies. The barriers may reflect economic or non-economic concerns, such as national security or individual privacy. Regulation of domestic service industries for domestic policy reasons has inhibited trade. The degree of restrictiveness of these barriers varies from one service industry to another; for example, insurance companies often face heavy restrictions in developing countries, while management consultants experience few restrictions on their activities.

Provision of telecommunications equipment and services is restricted to varying degrees by different countries. Developing countries tend to have fairly restrictive policies in an effort to reserve their domestic markets for indigenous producers. Market reserve policies of this nature tend to affect increasingly greater segments of the industry as indigenous capacity and technological know-how develop.

Brazil provides an excellent example of such a market reserve policy. The Brazilian government combines the use of import and export restrictions, investment requirements and various industrial policies to encourage the growth of its domestic computer and telecommunications capabilities. When a product or service can be provided by Brazilian companies, those respective market segments are protected to give the infant domestic industries time to develop. At the same time, foreign affiliates in Brazil are encouraged to shift toward the provision of more sophisticated products and services.

With few exceptions, most developed country markets are protected by monopoly post, telephone and telegraph (PTT) companies which most often are government-owned and operated. Until recently, the United States telecommunications market was dominated by a private monopoly. Within these monopolistic markets, there are varying investment requirements, tariff restrictions, interconnect restrictions, licensing requirements, local content requirements, and so on. Most of these restrictions are justified on the basis of protecting the integrity of the national telecommunications network and national security.

In the last few years, in addition to the break up of American Telephone and Telegraph in the United States, Japan and the United Kingdom have taken preliminary steps that may result in deregulating their telecommunications markets.

In Japan, the Diet is considering two bills. One proposes significant changes in foreign investment restrictions for providers of basic and enhanced services. The second bill proposes gradually privatizing Nippon Telephone and Telegraph, the domestic government-owned monopoly provider.

In the United Kingdom, the government has begun to liberalize and privatize British Telecommunications, the domestic and international carrier for basic and enhanced services. British Telecommunications' monopoly hold over the domestic market was broken with the government's decision to permit a second corporation to provide domestic long-distance services. The British legislature has also enacted a bill calling for the privatization of 51 percent of British Telecommunications to be completed later this year. At the present time, British Telecommunications still retains 95 percent of the market.

The flow and processing of information across national borders has caused increasing concern in many countries for economic, political and national sovereignty reasons. These concerns have heightened with the increasing convergence of computer systems and telecommunications networks.

Developing a well-defined international discipline in services

At the United States' initiative, discussions of a service sector agreement have begun both within the GATT and the OECD. The GATT Secretariat is beginning to receive studies by member countries examining the issues concerning service sector trade. The 1982 GATT Ministerial declaration also invited interested countries to review the results of these studies as well as information provided from other sources at the annual meeting of contracting parties scheduled for 1984. At that time, it was planned that the contracting parties would consider whether any multilateral action concerning services issues would be appropriate and desirable. As yet there seems to be no consensus on whether the trade in goods principles of the GATT can apply to services trade. Neither is there a consensus among the contracting parties that development of a services agreement is desirable.

The United States believes that GATT is the appropriate forum for discussions on this issue because (1) its membership is larger than that of the OECD and includes both developed and developing countries and (2) GATT provisions are binding, while those of the OECD are not. These same two factors, however, are also those which will make agreement exceedingly difficult to achieve.

Similar discussions in the OECD have progressed somewhat further. OECD protocols and agreements, although non-binding and limited to developed country participation, have historically been construed to apply to trade in goods and services, and thus

initiating discussion in this forum has not been as difficult. Discussion of these issues in the OECD is also easier because of the more common interests of its developed country membership, although agreement is still not easy to achieve.

The OECD Trade Committee, Working Party on Services has embarked on an ambitious effort to identify the nature and extent of barriers to service sector trade in its 24 member countries. In addition, this Committee has held extensive discussions concerning the potential application of basic trade principles to trade in services.

The trade principles of primary concern in services trade are non-discrimination (or most favored nation treatment), national treatment, right of establishment, minimum protection, and reciprocity. At present, there appears to be some agreement that the principle of non-discrimination could be applied to services on a conditional basis. However, some countries are concerned that applying non-discrimination on a conditional basis would imply reciprocal treatment and could lead to a more restrictive environment than currently exists in services trade.

The applicability of the national treatment principle to services is not so straightforward and has resulted in considerable debate among OECD members. These discussions have focused primarily on the extent of national treatment coverage. In other words, should national treatment apply to (1) imported services, (2) the ability of service companies to establish operations in

foreign countries, and/or (3) the "rights" of a foreign subsidiary once it has been established in a host country? Generally speaking, there is consensus that national treatment could not apply literally in services, and that exceptions to this principle would have to be clearly and carefully defined. Adopting a principle of national treatment in and of itself, however, would not ensure open trade. For example, the existence of national monopolies in the telecommunications industry could preclude operations by both domestic and foreign firms without violating the national treatment principle.

An additional principle being debated in the OECD deals with minimizing the level of regulation applicable to service industries. The debate focuses on host country regulations affecting service industries and the extent to which these are considered reasonable. This principle parallels the GATT principle of minimizing protection granted traded goods.

In both the OECD and GATT forums, a significant amount of work must be done before meaningful negotiations on a discipline governing service sector trade can begin. The applicability of the issues discussed above to each specific service industry must be fully assessed. Agreement must be reached on the "applicability" of GATT to service sector trade and the usefulness of trade in goods principles to service sector trade. Moreover, the concerns of the developing countries with regard to any discipline that is finally concluded must be resolved.

At present, it would appear that negotiations on trade in services are likely to be approached through consideration of

principles that could relate to all service industries and concerns unique to each service industry or like grouping of service industries. It is conceivable that agreement may be achieved on the general applicability of the principles discussed above. However, our discussions with numerous government officials indicate that this general agreement would have to be carefully analyzed in terms of its impact on specific industries within the service sector. Given this and the significant reservations expressed about a discipline on services by both developed and developing countries alike, negotiations on both a multilateral and bilateral basis are likely to be protracted and difficult.

EXCEPTIONS REMOVE TRADE IN AGRICULTURAL PRODUCTS FROM GATT DISCIPLINE

Many of the problems in agricultural trade result from policy decisions by countries in support of important domestic objectives. These include the price of food, self-sufficiency and security of supply, and raising the income level of farmers. As a result, domestic policy objectives tend to override trade considerations making negotiations difficult.

The problems in developing and enforcing rules for agricultural trade are very basic. To begin with, there is no internationally accepted definition of the term "agriculture" as used in trade and it is not defined in the General Agreement. GATT articles exempt trade in primary products from some of the disciplines applied to trade in manufactured goods. For example, Article XVI specifies that the contracting parties should seek to avoid the use of subsidies on the export of primary products but

then goes on to describe the conditions such subsidies should meet if they are granted. These conditions include, among others, the requirement that countries should not gain more than an equitable share of world export markets. Substantial disagreement exists over defining both what is a primary product and what is a country's equitable market share. Article XI, which generally prohibits the use of quantitative restrictions, allows such restrictions on agricultural products when they are necessary to enforce domestic marketing or production programs or to remove temporary surpluses.

Because of the problems arising in agricultural trade, the work program of the 1982 GATT Ministerial established a Committee on Trade in Agriculture to examine all measures affecting trade, market access, and competition and supply in agricultural products, including subsidies and other forms of assistance. This examination is to be made with a view toward achieving greater liberalization in trade and greater transparency. The Committee is to make appropriate recommendations to the GATT Council.

GATT's Committee on Trade in Agriculture reported last fall that submissions from 23 countries and the European Community showed an extensive panoply of restrictive practices affecting both imports and exports, which were often justified through GATT Articles. These practices include customs duties, sanitary and phytosanitary regulations, various prohibitions, state trading enterprises, quotas, subsidies, various forms of price supports, and voluntary restriction agreements.

Dispute settlement mechanisms in both the General Agreement and the Subsidies Code have been used to discuss and mediate problems in the international agricultural arena. Disputes between the United States and the European Community over exports of wheat flour and pasta both resulted in GATT panel examinations and reports. Each party refuses to accept the panel report which found against its practices, however, and bilateral negotiations are ongoing.

There have been some pressures for change in domestic agricultural programs which may have an impact on trade. These have been prompted, however, not by trade considerations but by domestic financial constraints. Generally speaking, the cost of maintaining farm programs is very high in most countries. For example, close to 70 percent of the European Community's budget goes to maintain price support programs under its Common Agricultural Policy. Increasing program costs and the expected enlargement of the Community have led to a new set of programs in the EC which may lead to fewer surpluses and therefore less need to export with the help of subsidies. Reductions in agricultural subsidies, as part of an overall program to reduce public sector expenditures, have taken place in Brazil in response to that country's international debt problems. Even in the United States, pressures resulting from increasing agricultural costs and budgetary deficits have led to changes in domestic programs.

Attempts to deal with trade issues are continuing. As noted above, the GATT is currently engaged in an exercise to have countries identify all practices in their agricultural sectors. A similar effort is underway in the OECD. There are also some discussions underway in these multilateral and other bilateral forums to establish new rules of appropriate behavior in agricultural trade in an attempt to bypass, and therefore solve, current differences in interpretations of existing rules.

Despite these efforts it is unlikely that an agreement to substantially liberalize agricultural trade will be concluded in the near future. The reality of large and politically influential farm sectors in many countries limits room for negotiation.

PROTECTIVE ACTIONS TO SAFEGUARD DOMESTIC INDUSTRIES

While the GATT is primarily focused on liberalizing trade in goods, one important exception is Article XIX, the safeguard clause. This clause provides the general framework under which signatory nations may take emergency measures to restrict imports when they threaten a domestic industry with serious injury. The key provisions of this Article are that

--serious injury must be present or threatened;

--this injury must be caused by the imports in question;

--consultations concerning any action to be taken should take place between the country taking the action and those it is most likely to affect; and

--if no agreement is reached during such consultations, the affected parties have the right to withdraw substantially equivalent trade concessions.

Article XIX provisions and other GATT articles have been interpreted to include the concepts that actions should be temporary and applied in a non-discriminatory, or most favored nation fashion. In addition, countries taking safeguard actions must notify the GATT of these actions, thereby ensuring transparency in the process.

The stringency of these features, particularly the serious injury standard, the requirement that safeguard actions be applied on a most favored nation basis, and the potential for demands for compensation, has made recourse to Article XIX a last resort measure. The drafters of Article XIX clearly intended to make its use exceptional rather than normal and routine. Indeed, the growing number of protective measures taken outside the framework of Article XIX and the GATT indicates that coutries do find the requirements burdensome.

The devices used most often in lieu of formal safeguard measures are informal arrangements, voluntary restraint agreements and orderly marketing agreements. There is flexibility in the design of these arrangements and they may or may not involve government participation. They are limited in scope and generally applied on a selective and discriminatory basis. Detailed information concerning these agreements is often restricted to the small group of countries directly involved. In addition, such actions have been taken when the GATT standard of injury has not been demonstrated. These actions are often referred to as grey area measures, so-called because their status under the GATT has not been determined, since they have not been brought into the GATT framework.

Attempts to develop a safeguard code

During the Tokyo Round of the Multilateral Trade Negotiations, there was an unsucessful attempt to negotiate an elaboration of Article XIX in the form of a safeguards code. Several critical features of the proposed code were not resolved, including (1) whether an action should be applied to the exports of a limited number of countries or to all exporters, (2) how to determine what constitutes injury, (3) the proper role of domestic adjustment mechanisms used in tandem with import restraints, and (4) whether there is a need for preferential treatment for the developing countries.

The 1982 GATT Ministerial work program called for the development of a comprehensive understanding on a more efficient safeguard system, to include the elements of

--transparency;

--coverage;

--objective criteria for action including the concept of serious injury or threat thereof;

--temporary nature;

--a progressive liberalization and structural adjustment;

--compensation and retaliation; and

--notification, consultation, multilateral surveillance and dispute settlement, with particular reference to the role and functions of the Safeguards Committee.

Although some countries' positions have moved closer to agreement in the intervening time period, progress toward reaching formal agreement has been extremely slow.

In part because of the slow pace of discussions, the United States and Canada have recently concluded an understanding on safeguards. The understanding sets out the procedures which the two countries will follow in applying any safeguard action which affects the trade of the other.

Actions in steel trade

The current lack of urgency in establishing a new code may, in part, reflect the ability and willingness of countries to take grey area measures. The steel industry provides some illustrations.

On a global basis, steel is a mature industry, one for which there is excess worldwide capacity and poor prospects for growth in demand. There are marked differences in the industry on the national level, however, with a number of countries establishing and expanding modern facilities, and differences on the sub-national level. For example, in the United States a profitable competitive minimill industry segment has developed in certain product lines.

As domestic demand in most steel producing countries has decreased, exports have become increasingly important. This in turn has led to greater pressure in importing countries with their own steelmaking capacity to limit increasing imports. Countries have used various means to restrict trade.

A number of actions have been taken outside the provisions of Article XIX. These include the following.

--The United States has entered into an agreement with the European Community to restrict the imports of steel into the United States in 10 product categories through 1985. This agreement resulted from a request by the European Community to enter into such an agreement after affirmative determinations were found by the United States regarding EC dumping and subsidy practices.

--Although there is no formal agreement, Japanese exports of steel to the United States have remained at a fairly constant percentage share of apparent consumption.

--The European Community has negotiated bilateral arrangements to limit steel imports to the EC with 14 countries.

Reactions to the U.S. safeguard actions taken under provisions of Section 201 of the Trade Act of 1974 on behalf of the specialty steel industry provide examples of the frictions which result even when all the rules are followed. In several discussions with European officials and producers, the U.S.-EC dispute over this case was cited as one of the most contentious and troublesome industrial problems between the United States and the Community. Even though the United States met all the criteria for taking a safeguard action, agreement between the United States and the Europeans on retaliatory measures was almost not reached.

A different cype of problem regarding this case involved Brazil. Brazil has stated that, although mechanisms appear to be in place which provide recourse to countries against whom restrictive actions are taken, Brazil, in fact, has no options. Because of the international debt crisis, Brazil is importing cnly essential items from the United States. Therefore, if no mutually acceptable arrangement to limit the imports of Brazilian

steel under a safeguard action can be negotiated, Brazil has few opportunities to withdraw substantially equivalent concessions without incurring additional costs.

The GATT safeguard provisions for the most part are designed to deal with emergency situations in which import surges injure or threaten to injure a domestic industry. The problems of the steel industry however, appear to go beyond trade issues. The European Community has underway an ambitious domestic program to cut substantial capacity and modernize the steel industry in member countries. According to EC officials, import restrictions do not play a major role in that process. In the United States, import restrictions have played a much larger role in policies toward the steel industry. Japan is just beginning to face similar problems as its steel imports are increasing.

Future discussions in the international arena on appropriate safeguard actions and procedures may likely focus on (1) limits on the types and conditions of unilateral actions which countries take to ensure that protection of uncompetitive industries is temporary or (2) requirements that such trade actions will be accompanied by domestic programs that have genuine industry adjustment as their goal. There is as yet no apparent consensus on those issues. In general, these problems reflect the wide divergence of views on the appropriate role of government in industry decisionmaking.

THE RISE OF BILATERALISM

We are also looking at the rise of bilateral trade arrangements and resulting trade issues from the perspective of identifying in one country new forms of export competition practiced by U.S. trade competitors in three sectors of great commercial interest to U.S. business--energy, aircraft, and informatics.

We chose Brazil as our case study, first, because last year the United States signed several bilateral trade accords with Brazil in the energy area which were meant to match the trade practices of certain European countries and, second, because Brazil's trading environment is characterized by industrial policy and debt-related import restrictions now common in many countries. Our focus is on our trading competitors' responses in exporting to such a trading environment and the trade issues affecting U.S. interests that have emerged as a result of these different responses.

The bilateral trade practices we have identified so far as important or emerging competitive factors in exporting to these sectors include (1) exclusionary government-to-government agreements, (2) financing practices, such as countertrade, bilateral clearing accounts, and export credits at below-market interest rates, and (3) compliance with trade-related investment performance requirements, such as technology transfers and export obligations.

For the most part these practices are not governed by existing multilateral trading rules, and we are seeking to learn

Whether U.S. firms are able and willing to compete in this environment and whether the U.S. government should assist these firms.

Bilateral trade agreements

Over at least the last decade, the Brazilian government has used detailed, government-to-government agreements as the basis for awarding long-term major projects contracts for some sectors.

Early in 1983 the U.S. government recognized such bilateral accords as the only method of gaining access to significant sectors of Brazil's large energy market. In April 1983 it signed several similar accords, or Memorandums of Understanding (MOUs), with the Brazilian government for developing Brazil's hydroelectric and thermoelectric resources. These accords, publicized in the United States as a flexible response to competitors' trade practices, are potentially significant as an instance where the U.S. government response to an exclusionary practice has been to imitate it. Brazil, like most developing countries, has not signed the GATT Government Procurement Code, and so the United States has had no basis to complain about its trading competitors' acquiescence to Brazilian government purchasing practices.

At the time these accords were signed, the Deputy Secretary of Commerce said that, if they were successful in Brazil, they could lead to similar agreements with other countries not subject to the GATT Procurement Code. In our present review we are seeking to learn (1) how these accords are working to help American exporters gain access to the Brazilian energy market, (2) how the

benefits offered by the U.S. accords compare with those offered by trading competitors' accords, and (3) to what extent such bilateral trade practices occur elsewhere in the world.

Preliminarily, we have found the accords to be moving on schedule in terms of American businesses working together with Brazilian partners. A major uncertainty for both U.S. and Brazilian firms, however, is the availability and terms of Eximbank financing for these energy projects, which are expected to total $1 billion in U.S. exports to Brazil over the next several years. Eximbank, unlike some European export credit agencies, does not establish lines of credit for countries and objected to any mention of Eximbank support in the U.S.-Brazilian agreements. In the fall of 1983, it did, however, announce a $1.5 billion facility to guarantee the financing of exports to Brazil. This facility is not specifically tied to the agreements.

In contrast to the detailed agreements signed between Brazil and other countries, the U.S.-Brazil agreements do not specify financing sources or individual firms; rather, they simply express the intent of the Commerce Department and the Brazilian Ministry of Mines and Energy to work together to facilitate the participation of their private sectors in reaching commercial agreements.

Elsewhere in the world, we have not so far found many instances of government-to-government trade agreements of the type U.S. competitors have signed in Brazil. Nevertheless, some trade

competitors, because of close government, banking, and business ties, are able to put together and negotiate complete project packages, and these in effect resemble their accords with Brazil.

Within the government there appears to be some uncertainty whether to more actively pursue such bilateral trade agreements. Commerce officials have cautioned that widespread use of such bilateral arrangements could encourage U.S. competitors to sign more explicit and exclusive agreements with less developed countries, resulting in the exclusion of U.S. suppliers and in increased subsidized export financing by other countries.

Nevertheless, the U.S. experience in Brazil with its bilateral arrangements has so far been positive, and further agreements are contemplated for access to other market sectors in Brazil.

Countertrade

Another trade practice emerging as a potentially important competitive factor and trade issue is countertrade. For financially troubled nations such as Brazil, which have been forced to cut imports in order to conserve foreign exchange to service their debts, countertrade can be a device to support imports. In our review, we are seeking to learn whether Brazil, in choosing among exporters vying for its markets, considers willingness to countertrade a significant factor, whether U.S. competitors are responding to this interest, and whether U.S. exporters are able to match the competition's abilities to countertrade.

Countertrade, often thought of as merely barter, actually encompasses an array of trade practices which do involve some exchange of money. Broadly stated, a countertrade transaction obliges the seller to purchase certain goods from the buyer as a condition of the transaction in order to offset the original purchase and reduce the outflow of scarce hard currency.

In our Brazil study, we have encountered various forms of countertrade and some instances where it appears to have been an important competitive factor. The Brazilian government does not formally promote countertrade, although it did create a state agency in 1976 to countertrade for its oil imports and it has set up bilateral clearing accounts with several East European and Latin American nations. However, as a condition for imports, Brazilian industry often seems to require some form of offset arrangement, guarantee of exports, financing package, and/or licensing agreement. We hope to learn more about countertrade activities in Brazil through a questionnaire of U.S. businesses involved in Brazil.

Although countertrade threatens an open, non-discriminatory multilateral trading system by foreclosing market sectors from competition based on price and quality, its use is not governed by the GATT. Current U.S. government policy generally opposes government-mandated countertrade, but on a recent occasion the government did engage in a barter arrangement for Jamaican bauxite. Otherwise, it seeks to remain neutral regarding privately-arranged trade deals.

Within the U.S. business community, on the other hand, there is a developing trend toward gearing up for increased use of countertrade; businesses and banks have established their own countertrade groups and export trading companies also serve a countertrade function.

An important trade question, we believe, is whether countertrade is a temporary phenomenon accompanying the current world recession or whether it may become an institutionalized practice as businesses become adept at finding profits in it. For the time being, in any case, most studies report countertrade to be growing in developing countries, and its importance as a competitive factor for U.S. exporters needs to be more clearly assessed.

Export financing tactics

Concessionary financing practices have been part of the competitive environment for many years, but have become increasingly important as a result of the debt problems of many U.S. trading partners.

During the late 1970s and early 1980s, foreign competitors seeking to export to Brazil were willing to provide a type of untied loan, known as parallel financing, in addition to the official export credit loan, to meet general balance-of-payment or local cost needs. Such loans are not covered by the OECD Arrangement on Export Credits, which governs such aspects of official export credits as loan terms and interest rates. These types of parallel credits have virtually dried up in Brazil over the last few years since most lenders have already reached their

debt exposure limits; but they could reappear as the debt situation improves.

Another financing tactic of increased interest now in Brazil is leasing, because International Monetary Fund financing conditions focus on improving Brazil's export balance and leased equipment is not recorded as an import in Brazil's balance of trade. Little is known currently about the increased use and trade implications of leasing, which as a financial service is not covered by the GATT. The U.S. government is making studies on this subject, and we also plan to collect information on competitive factors in this area.

The use of mixed credits (e.g., aid blended with official export credits) has not been a major competitive factor in Brazil, since France, West Germany, and Japan have not recently had large aid programs there. Mixed credits, however, continue to be an important competitive factor elsewhere in the world. U.S. competitors' aid programs are not as closely defined as those of the United States, and they have had more flexibility to offer the very low-interest mixed credits that our Congress has now directed Eximbank to match on appropriate occasions. The United States within OECD has supported increasing the grant element of these mixed credits to clearly distinguish them from commercial transactions, but has not so far been successful.

In terms of relieving Brazil's recent debt problems, however, the United States has led its competitors in providing financing as part of the debt renegotiations and did take the unusual step last fall in announcing the $1.5 billion Eximbank loan guarantee facility.

Compliance with trade-related investment performance requirements

In sectors where Brazil has active industrial policies, such as informatics and aircraft, an emerging key factor vis-a-vis U.S. trade competitors is likely to be willingness to comply with Brazil's trade-related investment performance requirements. These requirements, increasingly frequent around the world, usually include local content, technology transfer, and export obligations. They also involve transferring majority equity to Brazilian partners. Through our questionnaire of U.S. businesses, we hope to get some information about how foreign competitors are responding to these Brazilian requirements. As you know, the U.S. government sought at the November 1982 GATT Ministerial to get investment performance requirements included under GATT discussions, but was not successful. Instead of continuing to press investment concerns multilaterally, the government has recently shifted its immediate strategy to negotiating bilateral investment treaties.

ADDITIONAL OBSERVATIONS

As we have mentioned throughout our discussion, the issues facing trade negotiators today are highly contentious, primarily because they involve discussion of issues which heretofore have been almost completely within the realm of national policymaking. The increased interdependence of countries in the last decade has made it more and more difficult to ignore the international consequences of domestic policy decisions. That most of these decisions are taken in response to important domestic concerns in no way limits their impact in the international arena.

U.S. trade negotiators are currently discussing the need for and agenda of a new round of multilateral trade negotiations. The impetus behind these discussions is a concern that the liberalization process achieved in previous GATT rounds is threatened by the recent increase in trade restrictions.

The general premise that discussions in the GATT and OECD on current trade problems should continue is widely held. However, the necessary preparation for a new round of formal negotiations, which would include the problems surrounding safeguards, services and agricultural trade, is substantial. A consensus on key underlying principles needs to be reached before formal negotiations begin. Without such a consensus it would be difficult to conduct constructive negotiations and the likelihood of concluding a meaningful agreement would be reduced. Inadequate preparation for a new round of multilateral trade negotiations could result in failed negotiations and have serious implications for the trading system.

This concludes my statement, Mr. Chairman. I would be happy to answer any questions you may have.

Senator MATHIAS. Thank you, Mr. Mendelowitz. I think we might ask the other members of the panel to let us have their views and then we can have some discussion.

Mr. Rohr.

STATEMENT OF DAVID B. ROHR, COMMISSIONER, INTERNATIONAL TRADE COMMISSION

Commissioner ROHR. Thank you, Mr. Chairman.

I am very honored, Mr. Chairman, to have been invited to appear before you today, not only because of the subject matter, which is very important to our country and the world today, but also because of the location that you chose for your hearing. First, I am very proud to be a near native of the great State of Maryland. Second, I am pleased to be in historic Baltimore because it is the birthplace of my parents.

In the next few minutes, I would like to discuss with you the role of the U.S. International Trade Commission and how we relate to the import challenge both the United States and the international trading system face today.

The events of the last 2 weeks make the subject of today's panel very compelling, I think. The International Trade Commission has made major decisions in these weeks about imports and their effects on a number of important U.S. industries. We at the Commission do in many ways feel as though we are "riding a rising tide of trade," as the New York Times recently characterized our work. Clearly, to survive in today's interdependent world market, U.S. business and labor will have to meet and beat vigorous foreign competition.

Perhaps no more visible sign of this vigorous competition exists than the current state of the U.S. trade account. The U.S. merchandise trade deficit has soared in the past several years. Some predict it will go over $130 billion this year. This——

Senator MATHIAS. I heard $150 billion the other day.

Commissioner ROHR. I have not heard that, sir. That is the highest yet.

Senator MATHIAS. Since we are praising Maryland, that is the figure I picked up at a meeting at Johns Hopkins University, which has to be viewed with respect, if not with agreement. [Laughter.]

Commissioner ROHR. U.S. imports are swelling, partly because of the dollar's strength and partly because many times imported goods are lower in price and sometimes even superior in quality to domestic goods. On the other side of the equation, our exports are down, especially to the developing countries, as Chairman Volcker pointed out, which were once our fastest growing overseas markets. Now they cannot afford to both buy American manufactured goods and meet debt repayment schedules also.

Particularly significant is the trade challenge posed by the newly industrized countries. Korea, Taiwan, Hong Kong, Singapore, and others have rapidly emerged as major competitors. With low labor costs and access to sophisticated technology, they have established export industries capable of competing on a global scale.

Given these circumstances and the extraordinarily slow pace of recovery existing in other major markets, it is small wonder we find ourselves faced with a major trade challenge. To meet this challenge as a nation, I believe we have to focus our attention on two major goals. One is to improve and strengthen our competitiveness, particularly our industrial competitiveness; and second is to ensure that U.S. firms and workers can compete on a fair and equitable basis in our own market.

It is our hope that the International Trade Commission can contribute to both of these goals. The Commission, as you know, is a nonpartisan, independent agency. We have a factfinding responsibility to advise Congress and the executive branch on trade matters and a quasi-judicial role to collect evidence, hear testimony, and render a determination about whether relief from imports is warranted.

As the last 2 weeks have shown, the Commission exercises an important role in the interpretation and implementation of U.S. trade laws. The volume of cases being filed under these trade laws has never been larger, and this relates to exactly those factors behind the trade deficit: the high value of the dollar, growing competition from developing countries, and slow economic recovery in major foreign markets.

Though most of the publicity surrounding ITC decisions involves so-called section 201 import relief cases—that is, complaints alleging serious injury due to high import penetration—the bulk of our caseload deals with infringement of U.S. patents, copyright and trademarks or alleged unfair trade from foreign dumping or subsidization.

A major area of growth in the Commission's caseload has been in unfair trade investigations under section 337 of the Tariff Act of 1930. This section prohibits unfair competition and unfair acts in the importation and sale of articles in the United States which injure efficient and economically operating domestic industries.

Looking just at the last 3 years, the number of filings of 337 complaints with the Commission has more than quadrupled, from less than one per month to four per month currently, and I believe we have something like 65 or 70 cases currently under investigation.

These investigations are a unique part of the Commission's workload, both substantively and procedurally. Substantively, they involve not only the broad public policy concerns of trade and the health of domestic industries, but also the narrow and highly technical issues of patent, trademark and copyright infringement or false advertising and "passing off." Procedurally, 337 investigations are the most adjudicative of the Commission's functions, involving hearings and factfinding by the administrative law judges.

I believe there are several reasons for the tremendous growth in this particular area of the Commission's work. The first is that section 337 offers American business an advantageous and expeditious way of resolving disputes involving intellectual and industrial property rights. While district court litigation involving patents can take upward of 5 or more years before a decision, the trade statute requires Commission action in most cases in 12 months and in particularly complicated cases 18 months.

Further, while plaintiffs used to be able to "forum shop" for a particularly advantageous court, the creation of the court of appeals for the Federal court, which is also the reviewing court for the Commission's decisions, has eliminated this perceived advantage of district court suits.

In addition, the remedies potentially available in a section 337 case, in particular a general exclusion order against the offending merchandise, may often be more advantageous to plaintiffs than those of the district court. The court, for example, may have difficulty obtaining jurisdiction over foreign plaintiffs, and its order against particular domestic defendants can easily be avoided by a foreign manufacturer, who can usually find unlimited new outlets for its products.

A good example of how effectively section 337 works is the Pac Man video game case of several years ago. Pac Man gobbled up Winky, Blinky, Inky and Clyde, but when Puck Man nibbled at his patent, Pac Man's owners successfully argued their infringement case before the ITC and obtained an exclusion order.

I would predict that the Commission's section 337 caseload will continue to grow at increasing rates, particularly as the private bar and domestic industry gains more experience and confidence in the fairness and utility of this provision of law.

In many senses, the true traditional bread and butter of the Trade Commission are the cases filed under the antidumping and countervailing duty statutes. Our commitment to fair trade demands that we vigorously enforce our existing trade laws that are designed to obtain foreign compliance with international trade rules.

These statutes represent the basis of our country's policy of fair trade. When action is taken under these laws in response to the unfair trade practices of foreign nations, we are not in my view pursuing a protectionist path at all, but one which is legally and ethically right.

Over the last 4 years, since the Trade Agreements Act of 1979 dramatically changed these laws, the Commission has handled a record number of unfair trade practice cases under the statute, 532, and this is increasing. Indeed, I believe 19 new cases were filed just this week before the Commission.

This large volume of cases, which we estimate have involved over $100 billion in domestic shipments and 25 percent of the manufacturing work force, is a clear indication of the importance U.S. businessmen attach to the import effect of foreign trading practices in domestic markets.

One of the most significant aspects of these cases is the potential for judicial review. The procedure is totally open and, whichever way a case is decided, the result can be challenged in the Court of International Trade. This potential for review allows all parties full knowledge of the Commission's decisions and decisionmaking process.

As I mentioned earlier, this year perhaps the part of our caseload most in the public's view deals with complaints under section 201 of the Trade Act of 1974. The objective of this provision of law is to protect domestic resources by providing temporary relief for industries that have been seriously injured by growing imports.

The statute provides for a breathing space from imports while the industry undertakes actions to restore a competitive posture.

We had an unprecedented five cases under section 201 this year. Four of the five determinations have now been made. We made negative determinations on stainless steel flatware and footwear a few weeks ago, and this Tuesday we found in the affirmative on about 70 percent of the carbon steel industry, which is greatly represented in the State of Maryland. Yesterday we voted affirmatively for the unwrought copper industry. Later in July, we will address the problems of the canned tuna industry.

These were very hard decisions, Mr. Chairman, for us to make, but I believe I can speak for my colleagues on the Commission in stating that we have conscientiously based our decisions on the letter and spirit of the law. If imports are a prime cause of serious injury to the industry, relief may be appropriate. Where foreign exporters are competing in this market fairly and imports are not the major factor causing serious injury to our domestic industry, protection is neither a viable answer nor one envisioned by the law.

This issue of competitiveness is very much on the mind of the Commission in carrying out its research activities. I am personally very concerned about the shift of trade patterns in the United States. We are increasingly exporting more primary products and importing more manufactured goods. By traditional definitions, you could perhaps say that we are moving in the direction toward less developed country status.

I believe firmly that this country must have a strong manufacturing sector. In this regard, the ITC can assist in that effort with the expertise developed by its industry analysts who study and report on competitive conditions and trade.

As part of its ongoing factfinding responsibilities, the Commission has gained much experience in studying competitive conditions. We have completed a number of competitive assessments on a variety of U.S. industries, such as telecommunications, which we have just completed in the past week, and such other industries as furniture. At the request of the executive branch, we have examined how renewal of the so-called Generalized System of Preferences and a potential free trade area between the United States and Israel would affect our ability to meet import competition.

We are producing a series of reports on foreign industrial targeting practices to increase the information base on this new challenge to U.S. competitiveness. The Commission also conducts ongoing surveys of import trends in product categories. One benefit of these surveys is to alert domestic industries of changes in import trends and competitive challenges.

All of these activities also help the Congress and executive branch to develop more informed and forward-looking trade policy. The ITC's role in offering its research and advice on trade policy is probably one of its least known and probably, in my view, most important functions.

When I opened my remarks, I referred to "riding a rising tide of trade." As I look to the future, I have to conclude that this rising tide will continue. Imports are going to continue to challenge U.S. firms at home and abroad. Foreign market share may decline as the world economy improves and the dollar weakens, but the chal-

lenge from our foreign trading partners is not going to go away. Nor should it, in a healthy competitive world market.

But while the competitive pressures will continue, there are indications that we will be better able to meet them. I think a return to steady noninflationary growth, a pickup in research and development expenditures, removal of government obstacles to efficiency and innovation, and a more experienced work force are among the factors which will help us in meeting this challenge.

Our national attitudes toward competitiveness are changing. Risk-taking, innovation, and long-term payoffs are again becoming important principles of American business.

It is important that our trade policy positions take advantage of our growing strengths and our knowledge that we must continually adjust to the conditions of a new economic world. If we continue to follow certain principles—pushing foreign governments to open their markets, seeking to ensure that trade is fair both in the domestic and international markets, and supporting policies which will enhance our economic growth and technological advancement—we will have gone some distance to assuring that as we ride this rising tide we will find ourselves navigating a successful course.

Thank you, Mr. Chairman. I would be happy to try to answer your questions.

Senator MATHIAS. Thank you, Mr. Rohr.

Mr. Feketekuty.

STATEMENT OF GEZA FEKETEKUTY, SENIOR ASSISTANT U.S. TRADE REPRESENTATIVE

Mr. FEKETEKUTY. Mr. Chairman, I would first like to extend Bob Lighthizer's personal apologies to you for not being here. He is tied up with a House-Senate conference on a matter important to trade and that is the issue of the FSC [Foreign Sales Corporation] and he thought that it was something he could not pass up.

Senator MATHIAS. We understand that, and I regret that he is not here, but I certainly understand the reason.

Mr. FEKETEKUTY. Like the previous speakers, I have a written statement which I would like to submit for the record.

Senator MATHIAS. Without objection, your full statement will be included.

Mr. FEKETEKUTY. I have a brief set of comments that I would like to make which would summarize the statement, plus amplify on it to some extent.

I appreciate the opportunity to appear before you to discuss the question of the adequacy of both the international rules of the GATT system and U.S. trade laws. I also think the broader context which you have established for these hearings, including the issues of debt and exchange rates, is altogether appropriate.

Both the debt problems of important developing countries and, more generally, the strength of the dollar are unquestionably important factors in our current trade deficit. We should not forget that the basic framework of domestic and international rules has been with us for more than 35 years, and the trade deficits that we are now experiencing are more of a short-term phenomenon, and

the framework of rules that we have had has served us during both periods of deficits and surpluses.

Let me turn to the U.S. trade deficit. Chairman Volcker has gone through a rather extensive analysis of its causes. As you have indicated, it could well be $150 billion. The administration's current estimate is $130 billion. This is clearly a matter of serious concern.

It is important, however, that we correctly analyze the causes of this deficit. In our view, there are three principal reasons for the deficit, as Chairman Volcker has already discussed.

The first is the high value of our currency, which has increased our imports and reduced our exports.

The second reason is that the United States is leading the world out of a recent recession. The effect of that is obvious. We have more income available, we can buy more from our trading partners, but they have problems buying from us because their economies are growing at a much slower rate than ours.

The third reason is the burgeoning debt of the developing countries, which has reduced their ability to buy our goods. The tremendous debt has meant that they have not had the money to make the kind of purchases from us that they have been making in the past. And it is also important to point out that in recent years our exports to them have been the fastest source of growth in our exports, so as this has been removed this has removed a very important element of our export growth.

There is no doubt that the prospective $130 to $150 billion trade deficit is putting great pressure on U.S. trade policy. The impact on U.S. import-sensitive industries is particularly a problem, since these industries have already been under strain as a result of longer-term adjustment forces. I would like to highlight three of these longer-term forces.

First, most import-sensitive industries are basic manufacturing industries that are experiencing a rapid introduction of more automated methods of production. Now, this affects us in two ways.

First, other countries, particularly Japan, have been faster in introducing these automated methods of production, and this means that they have been squeezing us out in terms of competitiveness. This has clearly been a factor in the auto industry. The Japanese auto industry has automated faster than ours.

But second, as our industries try to catch up in the introduction of more automated methods of production, they clearly displace workers. And this has been going on. We have clearly seen that in steel and textiles and autos and many other industries.

The second longer-term adjustment that is occurring is the growing competition that we have been getting not only from Japan, but from many of the newly industrializing countries. As these countries have become more successful in developing their economies, they have become forceful competitors in many of these traditional industries, and they have been displacing us in world markets, as well as becoming more of an import factor in our own market.

Third, the rapid rise in the price of energy over the last 10 years has reduced demand for many of the basic products, like steel, since many industries are trying to replace steel with lighter materials. At the same time, the introduction of new materials, such as

the optic fibers, conducting plastics, and so forth, has reduced the demand for products like copper.

So we have had long-term changes going on at a much more rapid pace than we have over recent years. These changes, on top of the effects of the recent recession, on top of the international effects of the exchange rate of the dollar and the debt problem in the developing countries, have clearly cumulatively had a tremendous impact on our industries.

These long-term adjustment problems that I have just discussed are shared by many of our trading partners, and this has led to another problem for us, because many of these other countries have responded to these long-term adjustment problems by substantially increasing the intervention in their own economies, by introducing subsidies, by introducing various targeting policies, and by protecting their own industries.

These unfair trade practices have created further problems for U.S. industries, both on the import side and on the export side. In the import side, countries with foreign subsidies have successfully forced us out of some of our own markets. On the export side, these same practices have reduced market opportunities abroad.

In combination, the economic pressures exerted on our industries from these long-term adjustments and from the trade deficit are quite severe. It should not come as a surprise to us that this has led to a substantial increase in the number of petitions for import relief, and Commissioner Rohr has just discussed this at some length.

We need to be sensitive to the problems faced by these industries, and in our view our trade laws and the international trade rules give us ample scope for dealing with the problems created in these areas. While I said that we needed to be sensitive to the problems of our basic industries, I would hasten to add that we also need to recognize that employment has been going up in all of these sectors, even in many of the more sensitive industries, and profits also have risen. This clearly was a factor in the finding by the ITC in the footwear case.

If I may, I would also like to say a few words about the adequacy of our trade laws and the international trade rules of the GATT. It is undoubtedly true that everything could always be improved and any shortcomings are undoubtedly brought into sharp relief at a time of serious stress, such as we are going through at this time.

It is our view, however, that both our trade laws and the GATT trade rules are fundamentally sound and do not need radical surgery. They have served us well and we should not make the mistake of attributing our current trade problems to any basic failings in our approach to trade. Indeed, the greatest danger we face at this time is that we will be tempted to solve problems generated at the macroeconomic level with trade measures that will permanently distort our trade.

Having said that we do not need fundamental changes in our trade laws or in GATT rules, let me, however, address the improvements that we think could help. The administration wholeheartedly supports, for example, the Danforth reciprocity bill. We also believe that a number of technical changes in various other trade provisions could prove useful.

As far as the GATT is concerned, the GATT work program adopted in November 1982 covers a number of institutional improvements in the GATT that we would like to see, including a new safeguards code, improved dispute settlement procedures, and a stricter discipline on agricultural export subsidies.

Moreover, the United States is taking a leading role in current efforts to prepare and initiate a new round of multilateral trade negotiations which would seek to expand trade rules in areas such as agriculture, services, and high technology products. Such a new round would also have to address the basic issue of adjustment in the world today and the dismantling of nontariff barriers that now hinder adjustment. We believe that a decision on a new round can be made and will be made in the course of 1985.

Mr. Chairman, there can be no doubt that we are going through a difficult period. In order to meet the public trust, we have to deal with the problems and solve them. At the same time, it is important that we maintain a long-term view.

Thank you, Mr. Chairman.

[Mr. Feketekuty's prepared statement follows:]

Statement of

Geza Feketekuty

Senior Assistant U.S. Trade Representative
before the
Foreign Relations Committee
Subcommittee on International Economic Policy
United States Senate

June 15, 1984

Mr. Chairman:

I appreciate the opportunity to appear before you to discuss the question of the adequacy of both the international rules of the GATT system and U.S. trade laws. I also think the broader context you have established for these hearings, including the issues of debt and exchange rates, is altogether appropriate. Both the debt problems of important developing countries and more generally the strength of the dollar are unquestionably important factors in our current trade deficit. We should not forget that the basic framework of domestic and international rules has been with us for more than thirty-five years. We are now experiencing record trade deficits, but within essentially the same framework of rules we have seen both deficits and substantial surpluses in the past.

Your request that I address both the international system of rules and domestic laws is also altogether appropriate. Trade is of course a question of both imports and exports. By ourselves, we could establish laws that restrict imports further, but we cannot directly legislate a lowering of barriers to our exports. Jobs created by exports are as critical as jobs threatened by import competition, and jobs created by exports reflect the most competitive parts of the U.S. economy.

Let me turn to the U.S. trade deficit. This year our trade deficit is likely to exceed $130 billion. This is clearly a matter of serious concern. It is important however, that we correctly analyze the causes of this deficit. There are three principal reasons for the deficit. The first one is the high value of our currency, which has increased our imports and reduced our exports.

The second reason for our trade deficit is that the United States is leading the world out of a serious recession. The effect of that is obvious: We have more income available, we can buy more from our trading partners, but they have a problem buying from us because their economies are growing at a much slower rate than ours.

The third reason is the burgeoning debt of developing countries, which has reduced their ability to buy our goods. We in the United States tend to overlook the fact that the developing countries are our best market. We sell more to them than we do to Japan and Europe combined. Indeed, some recent figures suggest that of all of our merchandise trade, almost 40 percent goes to developing countries and about 45 percent of our manufacturing exports go to them.

Over the course of the last year or so, the tremendous debt problem in developing countries has meant that they have not had the money to make the kind of purchases from us that they had been making in the past. During the course of the last year, exports to high-debt developing countries fell by 24 percent; this is an enormous drop, and it accounts for a large part of our trade deficit problem.

There are those who would have us deal with our trade deficit by imposing import barriers, but in our view this would be a short-sighted policy.

I think it is accepted that the vicious spiral of international protectionism begun in 1930 worsened and prolonged the worst depression of this century. In the aftermath of World War II, the negotiation of the General Agreement on Tariffs and Trade created a durable multilateral framework for international trade liberalization, under which we and our major allies have enjoyed unprecedented economic gains.

The United States is committed to the GATT. We acknowledge that the GATT is the principal international body for negotiations on trade barriers and the liberalization of trade. We certainly believe that the liberalization of trade and the removal of trade barriers are in the interest of the United States: It is good for our economy and for the standard of living of our citizens. There has been, in fact, a ninefold increase in international trade since we began the GATT system in 1948, and a large part of that increase has benefited the United States directly.

The GATT system had its golden years during the 1950s and 1960s. Trade expanded tremendously. There were six rounds of tariff cuts that had the effect of reducing tariffs substantially. And then we had a series of crises in the 1970s which put a lot of strain on the system and which really brought us to this crucial point where we are right now. We think that the GATT system is under a great deal of pressure and has to either move forward or lose a great deal of its value.

U.S. policy toward the GATT has several objectives, some short-term and some long-term, that will dictate whether the GATT moves forward and deals with the new issues created by the current state of the world trading system or whether it will start to lose some of its value and lead us to explore alternatives.

Our first short-term objective is concern with the dispute settlement procedure. A high priority of the United States is to try to strengthen the dispute settlement procedure, to make its rules more enforceable. Right now, when a country brings a case against another country claiming some violation of the GATT, the case goes to a panel. On occasion the panel draws some conclusion and recommends a way to resolve the issue. As things stand now, the country that loses the case can block implementation of the panel's recommendation. This is something that troubles us and that we think ought to be changed.

Second, we think more work has to be done on the question of safeguard actions, so-called Article 19 actions, which are taken to protect domestic industry from import competition in cases where such competition is injurious. We advocate notification of such actions in all instances, and we believe these actions should be temporary, not permanent, to minimize their distorting effects on the system.

Our third objective is to strengthen the application of the GATT in agricultural goods. To date, GATT has brought about very little discipline to agricultural trade, which is an enormous part of the trade of the United States. We export about 40 percent of our agricultural product in this country. Obviously, we have

a very large stake in the imposition of some discipline in the agricultural sector. Work is under way on a Committee on Trade in Agriculture which, we hope, will move in that direction.

Yet another short-term objective is to increase the dialogue between the so-called North and South countries, the developed countries and the developing countries, to try to devise some rules to help us in our dealings.

With regard to our long-term objectives, I would cite four directions that we think the GATT has to move in if it's going to maintain its effectiveness. The first is the need to limit commercial counterfeiting.

The second deals with trade in services, which has become a very big part of the U.S. and world economy. But there are no international rules of any consequence dealing with trade in services. We have asked for a work program in the GATT on this issue, and indeed there is some work now being done.

The third area in which we need additional discipline is high technology. That is indisputably a very big part of future economic growth. We have asked for a GATT work program to develop rules with respect to high technology. The Europeans and other countries, however, have objected to this.

The fourth area is investments. Clearly, we do not have international or multinational discipline in the manner that governments deal with foreign investments. We think a work program ought to be developed in this area.

While we see some flaws and we have proposed some changes in the GATT system, we see no real alternative to it at this point. We are committed to the GATT system. We think it has

served the interest of the United States very well, and we hope it will continue doing so.

I want to turn now to the U.S. remedies against unfair foreign trade practices and to the various proposals for trade law reform.

This Administration has enforced the unfair trade laws of the United States in a tough and timely fashion, consistent with the spirit and intent of Congress in the Trade Agreements Act of 1979. The purpose of the Trade Agreements Act was to reform the antidumping and countervailing duty laws to create a speedy and effective form of relief for industries suffering from unfair foreign dumping or subsidy practices. Congress wanted to put an end to the dismal performance of earlier years, when the administration of the laws was characterized by bureaucratic foot-dragging and a failure to collect years of accumulated duties.

We have carried out the Congressional mandate of the 1979 Act.

1) We have conducted more antidumping and countervailing duty investigations than ever before in the history of the laws.

2) We have issued more affirmative findings of dumping and subsidization than at any time in the history of the United States.

3) We are completing the investigations on time and we are collecting duties from importers who are subject to antidumping and countervailing duty orders.

Today, I can say with assurance that the United States is the most vigorous and aggressive enforcer of the International Anti-dumping Code and the International Subsidies Code in the world.

We have enforced our other trade statutes as well. The President has granted import relief under the so-called "escape clause" of section 201 of the Trade Act of 1974 to the heavy-weight motorcycle industry and the specialty steel industry. Quotas and duties are in place at this very moment to ensure that these industries have time to recover and regain their competitiveness. Under section 301 of the Trade Act of 1974, this Administration has initiated an unprecedented number of investigations of foreign practices which burden or restrict U.S. exports. We have not hesitated to go toe-to-toe with foreign governments to combat unfair foreign subsidies and quotas which restrict our exports to overseas markets. In GATT dispute settlement proceedings, we succeeded recently in obtaining Panel decisions striking down Japanese restrictions on leather imports and the European Communities' interpretation of the threshhold provision of the Government Procurement Code. We have used every tool available under U.S. law to defend our interests.

Recently, however, some have argued that the trade laws of the United States are inadequate to deal with the "new protectionism" of today. Several trade reform bills are now before Congress, including Congressman Gibbons' Trade Remedies Reform Act of 1984.

The Administration supports the concept of a limited fine-tuning of the antidumping and countervailing duty laws. It has

been over four years since the passage of the Trade Agreements Act of 1979. Our experience with the laws has shown areas in need of revision. Certain provisions of the laws increase the costs and burdens of conducting investigations but contribute little to the accuracy or fairness of final decisions. We support the concept of a limited reform of the laws to make it cheaper for companies to seek relief and to improve the access of small businesses to trade remedies.

The Administration, however, strongly opposes the massive overhaul of the trade laws contemplated by the Gibbons bill. We particularly oppose three provisions of the bill, those relating to (1) "export targeting subsidies," (2) natural resource subsidies, and (3) downstream dumping. While we are sympathetic to some of the concerns underlying these provisions, we believe that the proposals are inconsistent with the General Agreement on Tariffs and Trade (GATT) and expose our exports to an unacceptable risk of foreign retaliation.

I would like to explain this point further. In essence, the GATT is a contract. We lowered our tariffs and agreed to abide by certain rules; other countries lowered their tariffs and agreed to abide by the same rules in return. If we violate the rules, the other countries are entitled to raise their tariffs because we have failed to carry out our end of the bargain. GATT-inconsistent legislation, like the Gibbons bill, creates a very real risk that other countries will seek to exercise their right to raise their tariffs on our exports. In the event of retaliation, the likely targets are our strongest export

industries, such as computers and agriculture. These industries could find themselves shut out of their most important export markets.

However, after thirty-seven years of the GATT system , it is easy to forget the benefits of reduced foreign tariffs and other barriers to our exports resulting from the existence of the GATT. Under GATT rules, billions of dollars in U.S. exports move with the assurance of fixed lower duties. I can assure you that our trading partners, whose economies have not yet recovered to the same extent as the United States, face great pressures to take actions contrary to their GATT obligations. I am also reminded, in my discussions with my foreign counterparts that the United States also has its trade measures which, while "legal" under the GATT, cause pain to our trading partners.

The world trading system is under very serious stress. Most countries, not just the United States, are having serious economic and trade problems. If we are not cautious, the whole system could come crashing down on us, to our great detriment.

Of course, that does not mean that we should not be fully vigorous in enforcing our trade laws and in pursuing our GATT rights. We believe we can do no less if we are to retain the support of the American public. We believe our record in this respect is a good one over recent years, and we intend to stay the course.

Senator MATHIAS. Thank you.
Mr. Wethington.

STATEMENT OF HON. OLIN L. WETHINGTON, DEPUTY UNDER SECRETARY OF COMMERCE

Mr. WETHINGTON. Thank you, Mr. Chairman. It is a pleasure for me to be here today and to be a part of these hearings.

I have been asked to address my remarks—and I do have a prepared text which I would like to submit for the record. I do not propose to read that text, but I propose to summarize from it and also to make some additional comments.

Senator MATHIAS. Your statement will be included in the record.

Mr. WETHINGTON. Thank you, Mr. Chairman.

I have been asked to address the question of the effect of the global debt situation on trade and trade finance. The trade area is obviously part of our purview at the Department of Commerce. We are not the lead agency responsible for the reschedulings and for IMF activities. Those, as you well know, are the purview of the Department of Treasury and the Federal Reserve.

Senator MATHIAS. And it is my view that they ought to be more closely related.

Mr. WETHINGTON. More closely linked with trade. That to some extent is the essence of at least some of my remarks, because there is a clear linkage between the global debt situation and trade flows. The global debt situation has had a very disruptive impact on international trade over the last 2 years.

In our own situation, our exports since 1981 have dropped about $37 billion. We attribute $27 billion of that to developing countries, many of those, the majority of those, being debtor countries, the result of their efforts to impose austerity domestically. With Latin America, which is the region that has the largest of the debtor countries, our exports are down $19 billion in the last 2 years.

With Latin America, we have gone from a surplus in 1981 of $3 billion to about $16 billion in 1983. The impact on the United States has been dramatic. It has affected employment. We estimate that employment is down as a result of the decline in exports by about 600,000 jobs, and we directly attribute our decline in exports to Latin America to a reduction of about 400,000 jobs.

Now, this is not in any way to say that Latin American countries and other debtor countries should not have made necessary adjustments domestically. We recognize, the world community recognizes, that there has been a need on their part to reduce imports by some level, and this has been proper.

Also, it has been recognized that there is a need on the part of the developed countries to permit the expansion of exports from these countries in order that they can earn the necessary foreign exchange. I think the United States more than any other country has been doing its part in that process.

The big six debtors in 1983 did increase their exports to the world. They increased them, though, by only 1 percent, whereas the United States absorbed an increase of 7 percent in export growth from the big six debtor countries. With respect to Brazil,

for instance, in 1983 the United States absorbed over 50 percent of Brazilian export growth.

The pattern is the same with other Latin American countries. We are doing our part. It is necessary, because of the global interest in working our way through this process of adjustment.

Now, one of the things we have been very much concerned about in the Department of Commerce, as have other agencies, is the impact of the debt situation on trade credit lines. If countries are not able both to export as well as to import, they are not able on a long-term basis, we believe, to take the kind of prudent economic adjustments which are necessary domestically.

They need imports to keep their engines of production going, and a condition of maintaining a prudent level of imports is that trade credit lines be kept open. What we have seen over the last 2 years is in fact a decline in availability of short-term trade credits.

This is understandable in the current context, but we believe that it is incumbent on both banks as well as governments to find ways in which to increase the availability of these short-term credits, because they are, if you will, in a fundamental sense the engine of economic growth by which these debtor countries can make the necessary long-term adjustments.

A third area of concern that we have had which is peculiar to trade is that the shortage of currency, of foreign exchange, has caused in many respects distortions in the way trade is being conducted. By that I mean we have seen a rise in barter, in countertrade, and in other forms of trade which we feel are not conducive to long-term open market policies that can enhance our mutual international well-being.

That has been the situation over the past several years. I would not in any way want to suggest that we are out of the woods, because we certainly are not. We still have concerns. There certainly are countries which are still in the process of significant reschedulings.

But I should say that to some extent we are optimistic as to the future. To a significant extent, we believe that we do have some good news to report in the present situation. The first, and I think the overriding, factor which gives us optimism is that we believe the robust U.S. economic recovery will lead the way toward an expansion globally of the economies of our industrialized trading partners. This will in turn pull up the rest of the world, and with them the debtor countries, and will provide increased opportunity for debtor countries to earn their way out of their current payments difficulties.

The second factor I would highlight is that in many of these countries we believe that the adjustment process is well underway. That is particularly true, we feel, in Mexico and to a somewhat lesser extent in Brazil. What we see in the case of Mexico in the first 2 months of this year is an increase, a rather substantial increase, in their imports, which means the economy is to some extent picking up—a rise of over 55 percent in the first 2 months of this year.

We estimate that Brazil, by the end of the year, will show some small increase in their imports as well and that both of those two countries, the two largest of the debtor countries, for the first time

in several years will move from negative growth to what we estimate will be, although small, some positive growth.

Progress has been made in the control of inflation, particularly in those two key countries, although much remains to be done, and their trade surpluses will be significant and will exceed, perhaps, the IMF targets. The IMF itself estimates—and this is consistent with our renewed cause for optimism—that imports into the largest of the nine largest debtor countries in 1984 will be up 12 percent, whereas in 1983 there was a decline in imports into those countries of some 9 percent.

The third point I would highlight from a trade perspective is that, although there has been considerable concern over the decline in availability of short-term trade credits, in recent months there has been some significant improvement, again particularly with respect to Mexico, where some important U.S. suppliers are now regaining confidence and are willing to ship to Mexican customers without requiring up-front cash or confirmed letters of credit.

The increase in imports, as I indicated, into Mexico and Brazil is some indication, some statistical indication of the improvement in the availability of short-term credits. We do have some optimism that that will continue.

As I said, we are not out of the woods, because there are several areas of significant concerns. Although we are making some progress in expanding the availability of short-term credits, there remain many exporters and many banks which are still hesitant to extend these short-term credit lines. Financing terms remain cautious, and we believe that the long-term viability of our approach depends on the continued willingness of banks and governments to make these short-term credits available.

We are also concerned that a number of developing countries are resorting to trade protectionism as a way of dealing with their domestic situations as part of their austerity programs. We believe that these import barriers which have been raised to shelter domestic industries have long-term consequences; that their imports are necessary, as I said, to further their long-term economic development.

Finally, I would mention that the investment climate also needs significant improvement. Even in the countries where we are most optimistic—that is, Brazil and Mexico—we believe that even further steps are necessary to enhance the environment for foreign investment in those countries. Investment opportunities can be an important factor in enhancing, obviously, capital flows to those countries, while restrictions on private sector investment can only have long-term detrimental impacts.

Let me stop there, Mr. Chairman. I would be glad to take your questions.

[Mr. Wethington's prepared statement follows:]

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Testimony of

Honorable Olin L. Wethington
Deputy Under Secretary of Commerce
for International Trade

Trade Finance and Promotion Policies
Responses to the World Debt Problem

Thank you for your invitation to testify today on the trade finance issue.

The last two years have been difficult ones for U.S. trade. The overhang of debt in the developing countries has disrupted our traditional trade patterns. I would like to focus on what has happened in the last few years, our assessment of the current situation, what the Administration is doing about it, and some remaining problem areas.

Recent Trade Developments

In the past two years, U.S. exports have faltered. During this period, our exports fell by $37 billion, or nearly 15 percent. Proportionately, the largest drop occurred in our exports to developing countries. These fell by $27 billion. Of particular interest and concern to us are the countries of Latin America. These countries include some of the largest markets for U.S. goods and services.

Our trade balance with Latin America deteriorated by $19 billion from 1981 to 1983 -- dropping from a surplus of $3 billion to a $16 billion deficit.

In the first four months of 1984, the U.S. deficit with Latin America amounted to $7.6 billion -- 55 percent greater than the $4.9 billion deficit for the corresponding period in 1983.

In terms of the direction of trade, the United States is now running a trade deficit with 7 of our 10 South American trading partners, compared to 1981 when we had a trade deficit with only three countries -- Brazil, Venezuela and Ecuador. With Mexico, our third largest trading partner in the world, in 1983 the United States has a trade deficit of $7.9 billion as opposed to a surplus of $3.6 billion in 1981 before the liquidity crisis erupted there.

The decline in U.S. exports to Latin America includes every major product category, while every major category of imports from Latin America except agricultural products, has increased.

On the export side, the largest decrease was in the category of metals, machinery and transportation equipment, which fell 56 percent in the last two years. This is the category where the U.S. is highly competitive and which accounted for over half our exports to Latin America before the debt crisis. The decline in exports of these products accounted for the bulk of the loss in overall exports to the region. In addition, the decline of U.S. exports in this category to Latin America in 1983 accounted for 98 percent of the worldwide decline in U.S. exports of these goods. The products within this category cover a broad range from aircraft, to mechanical shovels, to compressors, to TV apparatus, to seamless pipe, to elevators. For a number of products, including parts for the auto industry, electrical switches and miscellaneous machinery, the decline in exports to Latin America was more than the global decline.

The decline is evidenced by lost exports in key products, e.g., an 86 percent decline in agricultural machinery -- 79 percent in construction equipment and 57 percent in civilian aircraft.

In other general product categories, the major dollar losses in U.S. exports were in certain agricultural products such as wheat, sugar beets, and pinto beans; and certain chemical mixtures, compounds, and fertilizers. Significantly, these are our second and third largest export earning categories to the region.

We expect that, as industrial nation recovery spreads to the developing countreis, they will undergo a transition from trade contractionary adjustment-- characterized by import cuts-- to a period of trade expansionary adjustment based upon export gains and import growth. The IMF estimates that for the nine largest debtor countries pursuing Fund programs, the value of imports will rise by 12 percent in 1984, compared with a decline of 9 percent last year. A 21 percent swing in one year!

Brazil and Mexico are both expected to grow this year. And while Brazilian imports were still declining in the first quarter of this year, Mexico's imports increased by over 50% from their depressed 1983 levels. This is a clear indication that recovery in trade and finance is coming to countries that have pursued appropriate adjustment policies. Nevertheless, more will need to be done to restore trade and finance to normal and sustainable levels.

The pace of debt reschedulings in the past two years understandably has shaken the confidence of lenders. It is clear that lenders initially reacted to actual or potential reschedulings by reducing sharply their credit extensions-- new loans-- to many developing countries. For the half-year ending June 30, 1983, available data show that bank lending to developing countries increased only $4.7 billion, compared against an $18 billion rise for the preceding six-month period. Corporations also followed suit in cutting back on existing credit and in declining to extend new credit.

These reduced credit facilities have discouraged U.S. trade:

- U.S. firms were less able to provide short-term trade credit for their shipments and allow buyers the essential leeway to process, distribute, and resell the goods involved. In allocating the limited availability of credit, preference was sometimes given to public buyers, to the detriment of the productive private sector in developing countries. Without sufficient credit, importers were forced to reduce purchases.

- Even when financing could be found, credit terms often became stricter. Repayment periods were shortened, interest rates increased, downpayment requirements enlarged, or additional security or collateral required. This too reduced the ability of developing countries to import.

Trade credit availability has improved somewhat, but the situation still is far from normal. In Mexico, for example, credit lines for U.S. corporate affiliates and blue-chip Mexican firms have largely been restored, but banks and exporters in the industrialized countries continue to shy away from many creditworthy, but non-blue chip, Mexican companies. We feel that more trade credit is needed, especially from private sources, and that the conditions attached to such trade credit should be reasonable. It is essential that financial channels be open to complete sales efficiently and without stringent requirements that impair the buyer's cash flow unduly and disrupt the economies of debtor nations.

Current Assessment and Administration Response

There is still no room for complacency or overconfidence. Nevertheless, I find solid ground for optimism. Significant progress has been achieved.

- Robust U.S. economic growth is leading the global emergence from recession. We had a six percent growth rate last year in real terms, and we are projecting a five percent rate for this year. Real growth in other major industrialized countries, only three percent in 1983, should gather steam this year.

- Economic recovery in the industrial countries is essential to accommodate the efforts of the developing countries to earn their way out of their debt problem. Developing countries can discharge their

debts only if they have access to export markets. We have kept our markets open to the developing countries. We have resisted pressures to raise economic barriers to trade, in accordance with our fair trade principles.

- Creditors have responded positively to the debt problem and demonstrated willingness and flexibility in rescheduling debt payments. The large scale reschedulings have not led to a collapse of the world financial system, as some predicted.

- The adjustment process is well underway. Some countries now are in a position to resume debt payments, which will help restore confidence. The leading success story in this regard is Mexico, which swiftly corrected its trade imbalance. Other countries as well have adopted corrective policies that should take hold soon.

- The availability of trade credit has improved significantly in the past year, especially for countries that pursued vigorous adjustment policies. Again, the best case is Mexico, where we understand that some important U.S. suppliers have regained confidence and are now shipping to some customers without requiring up-front cash and confirmed letters of credit.

- Developing countries and their bankers are taking cognizance of trade credit issues when formulating new borrowing requirements. Initially, the focus was mainly on the implications for the world financial system, with

less attention paid to trade finance issues. Now it is broadly acknowledged that trade and finance are inextricably linked and that both are critical to the economic prospects of the developing countries.

In addition, I would like to cite some of the more specific steps taken to help keep trade credit lines open.

- We provided large-scale official credits in selected cases to support adjustment efforts and help developing countries cope with their financial difficulties. During the past 12 months, the Export-Import Bank extended more than $2 billion in extraordinary credit facilities to Mexico, Brazil, and other countries to sustain U.S. trade flows. The Commodity Credit Corporation also has provided substantial financing. Further, we have enlisted the cooperation of other major industrialized countries in providing immediate financing. We encouraged private lenders to be flexible and responsive.

- The Administration took the initiative to ensure the availability of adequate resources. Administration budget requests for Eximbank have increased, currently standing at a total of $13.8 billion for 1984. For 1985, a like amount has been requested. These resources should suffice to ensure that U.S. companies can continue to supply essential goods and services to developing countries.

- We are giving special attention to the financing problems of smaller U.S. firms. Early in this Adminstration, Eximbank adapted its popular loan programs to ensure that smaller sales were being supported on the same basis as large sales. Also, Eximbank initiated a working capital guarantee program for smaller firms pursuant to the newly-enacted Export Trading Company Act.

- Eximbank has expedited its payment of claims to businesses on debt delinquencies. The debt problem's sudden onset put financial pressure on some U.S. companies that extended credit on foreign shipments. Eximbank has increased its staffing in this critical area. Payments to U.S. exporters on claims are now being made on a more timely basis.

- We at the Commerce Department also are intensifying our efforts to help U.S. exporters collect their debt promptly. The Foreign Commercial Service is making concerted efforts to assist companies in debt collection. Also, the U.S. Commercial Service is actively engaged in providing advice and counsel to firms seeking to export under credit terms.

Some Remaining Areas of Concern

We are not yet out of the woods. I would like to leave to others the discussion of the balance of payments effects and debt rescheduling policy and focus on trade problems.

- Many exporters and banks still hesitate to extend trade credits. Financing terms remain cautious, and their restrictiveness is compounded by newly-imposed foreign exchange regulations.

- Developing countries have responded to their debt problem by generating export surpluses by cutting their imports, mainly, rather than by expanding exports. In my view, we cannot and should not expect the import side to take much more of the burden of adjustment. The import cutbacks have contributed to slowdowns in economic activity and fostered political and social unrest. Sometimes, import restraints proved counterproductive when export production was deprived of needed imports. We believe the wiser long term course is a policy of market-oriented, export-based adjustment.

- We also are concerned about tendencies in some developing countries to resort to trade protectionism as a means of coping with their debt problems. Import barriers have been raised to shelter domestic industries. Also, subsidies have been granted for exports, to which we have had no choice but to enforce our existing trade laws. Foreign exchange controls have proliferated. In our view, reducing these distortions to trade would not only augment resistance to protectionism generally, but would also favor economic efficiency, optimal resource alloction, and export incentives in the developing nations themselves.

- The investment climate also needs improvement. Among the restrictive measures are multiple exchange rate systems, foreign exchange controls, and rigid import licensing mechanisms. Foreign direct investment can play an important and constructive role in enhancing capital flows to developing countries. Further, investment encourages the productive private sector to contribute to the national economy and hasten the resolution of debt problems. But if the potential benefits are to materialize, host countries must do their part to create a more positive environment for investors. Policies should be adopted to provide equal treatment for foreign investors, allow majority ownership and management control by the foreign investor, and administer more flexibly and equitably official regulations on price controls, performance requirements, and the like.

In conclusion, I would like to urge that the time-honored instruments and terms of short-term trade financing be respected to the greatest extent possible. Short-term credit, which reschedulings often leave unaffected, plays a critical lubricating role in the routine transactions that make up the bulk of international trade.

I can well understand how a debt rescheduling situation can give rise to uncertainty and temporarily interrupt observance of the customary rules on short-term credit. But observance of these rules should be swiftly restored. Debtor countries need to continue trading, after all, and it

is contrary to their own interests to jeopardize short-term trade financing. If suppliers perceive that the integrity of the rules is being relaxed, it will be that much more difficult for the country to obtain needed financing for imports. Worse yet, a general deterioration of the rules should affect adversely the recovery efforts of other, innocent bystander countries.

Mr. Chairman, this concludes my testimony. I would be happy to answer any questions you or the Committee may have.

Senator MATHIAS. I thank all of you gentlemen for your statements. When we view these problems in Washington, we tend to view them from a statistical point of view. We look at the numbers and documents.

When we look at them in Baltimore, I think it has a more human dimension because we are looking at people who themselves are either out of work or know someone who is out of work, or have some relative out of work. So it impacts in a very personal way.

Recently I met with officials of the Bethlehem Steel Co., which has a very large plant here, and asked about the impact of exchange rates on steel import problems. They estimated that it was a very large impact, accounting for somewhere between a third and a half of the increase in imports.

Would you feel that that is a fair estimate of the overall trade problem. I will not limit my question to you to steel. Of course, there are other problems—the debt crisis, the slow growth in other parts of the world, the U.S. recovery—which are all factors as well. But would you consider that the overvalued dollar is somewhere around a third to a half of the whole problem?

Mr. WETHINGTON. That is close to our estimates. We estimate that if the dollar were to return to levels where it was at the turn of the decade, 1979–80, that we would see the elimination of roughly half, over a several year period of time, of the present $100 billion plus trade deficit. That is a rough estimate, but your estimate conforms closely to our sense of what the likely impact would be of a decline in the value of the dollar of roughly that amount. It would vary by sector.

Senator MATHIAS. Are there any disagreements with that?

[No response.]

Senator MATHIAS. What role or what importance would you assign to protectionist measures in other parts of the world as causes of the trade deficit? Mr. Mendelowitz, you look thoughtful on that point.

Mr. MENDELOWITZ. I have to tell you, when I am asked a particularly difficult question like that I sort of feel envious of Paul

Volcker. It is not just that he is so brilliant, but he also smokes a cigar.

Senator MATHIAS. Yes, and he can tap the ash for a moment or two.

Mr. MENDELOWITZ. Or puff on it and think a little bit.

To be honest, we really have no quantitative estimates, and I am not sure that it would be possible to arrive at that. Based on the list of types of trade-restricting agreements that we have come up with, we obviously feel that trade restrictions and barriers have been an important element.

How much, we cannot say, because when you talk about the balance of payments or the balance of trade you are talking about a net figure. Opportunities for the U.S. to export have been restricted however, at the same time, on the import side we are importing less because of our own trade barriers and trade restrictions. So it is hard to say on balance what the impact is.

Senator MATHIAS. Does anyone else want to comment? Commissioner Rohr?

Commissioner ROHR. Mr. Chairman, I am not in the business of looking at foreign import restrictions, but I would like to share with you some information that we get in our various investigations on domestic trade problems. For example, in the footwear industry we heard from one witness after another that the United States is the most open market in the world for footwear. Except for a tariff, there are no restrictions on footwear trade in this country.

On the other hand, the very countries that export footwear to the United States are those countries with the highest protective devices, both tariffs and quotas. So at least in the industries that we hear from, the ones that we are investigating, perhaps foreign country protection really is an element that has something to do with our trade deficit. That is my main concern.

Senator MATHIAS. All of you have mentioned at one point or another that you saw some improvement in the position of the larger debtor nations. Our own growth is leveling off. On the committee we find it somewhat confusing that, with these factors which should improve our trade situation, the trade deficit is growing. Let us hope that we will get to neither $120 billion or $150 billion by the end of this year.

But in any event, it looks like the 1984 year is going to be a worse year in terms of trade deficits than 1983 was. Now, why is this happening when these factors are beginning to come into play that ought to be mitigating the problem? Mr. Wethington?

Mr. WETHINGTON. I think there is always some lag in the impact of some of these macroeconomic factors on our trade situation. To some extent there are some factors which cut in opposite directions. As our domestic economic situation gets better, we will draw in imports from other countries. Those imports will in time strengthen those economies and will have in time a reverse effect, because we will in turn be able to take advantage of increased demand in foreign countries for our own exports.

But there is some lag time in that process. We are optimistic that there will be, I think, the beginnings of a downturn in the trade deficit in 1985 and 1986. We hazard to predict exactly how

much that is going to be because of the very important factor of the value of the dollar. We think that will come down somewhat.

But certainly the dollar is a very significant factor, I think more significant even than the protectionist measures you made reference to, although those are certainly, particularly in many special situations, the overriding factor. So it is difficult to generalize, I think, in relative terms as to the weight which we should assign these various causative factors.

Senator MATHIAS. Thank you.

Mr. Mendelowitz.

Mr. MENDELOWITZ. Mr. Chairman, I would like to add to the discussion the fact that I would say the die is essentially cast for 1984 and early 1985. Not only is there a lag with respect to macropolicy, and as long as the U.S. economy continues to grow at its current vigorous rate, we will be sharply increasing our demand for imports, but even if the dollar were to decline and we are as yet not taking any of the fundamental steps that I think would indicate a near-term decline of the dollar, there is a lag of something on the order of 12 to 18 months between the change in the value of a currency and when that change really begins to have an impact on the balance of trade.

So were the dollar to begin to decline today, we likely would not see the real impact of that decline on the balance of trade until late 1985 or early 1986.

Senator MATHIAS. I think I heard you say that you do not expect the dollar to decline in value because we are not undertaking the steps that are going to make it decline?

Mr. MENDELOWITZ. I want to rephrase my answer a bit.

Senator MATHIAS. But I am not urging you to.

Mr. MENDELOWITZ. I just want to clarify it. I would like to say that we are not taking the fundamental steps now that would in the long run, I think, produce a more reasonably valued dollar.

Now, the dollar may decline. I am not in the business of predicting what is going to happen to exchange rates.

Senator MATHIAS. Under what conditions would you expect it to decline? What steps would you see as necessary?

Mr. MENDELOWITZ. I think that the fundamental problem is that, given the extent to which capital markets and goods markets are integrated amongst the major economies of the world, we essentially have constraints placed upon the mix of monetary and fiscal policy that we can adopt without paying a fairly high price in the international arena.

I think that is what has happened to the United States over the past 3 or 4 years. The high-interest rates and the high value of the dollar are both symptoms of the same set of policies. If you have a fairly large fiscal deficit and you have a fairly restrictive monetary policy, you will push interest rates up and you will push up the value of your currency.

I think if we were moving in the direction of a somewhat more balanced monetary and fiscal policy mix, with a reduction of the fiscal deficit, I think we would be moving in a fundamental direction that would be both desirable from a domestic policy objective and international economic objectives.

Senator MATHIAS. Let me address this to each member of the panel, because I am sure that those who are here in the room who are shippers and exporters want some sense of direction. All things considered, what do you think the prospects are for U.S. exports, say for the next couple of years?

Do you think the trends are more favorable for American exports? Are there any leaders, any strong elements? Mr. Feketekuty?

Mr. FEKETEKUTY. Mr. Chairman, I think the prospects for U.S. exports will be fairly good. First of all, we heard from Chairman Volcker how the situation in many developing countries is beginning to improve, and as they get any leeway at all they will clearly be increasing their imports once again.

More importantly, I think that growth in Europe is beginning to take hold, and I think as that continues we should expect to see a fairly large increase in exports to Europe.

But more fundamentally, I think we have made some very important fundamental adjustments in the economy. We have introduced great efficiencies, overhead has been cut down. I think the United States is going to come roaring into the world market a few years down the road. Whether it will take 1 year or 2 or 3 years, I do not know. But we have made so many fundamental corrections that I think we will be extremely forceful competitors down the road.

I am fairly confident in American technology and in the American ability to be competitive. I think the hard decisions are being made by the American business community, and I think this will put us in a very good position on the export side.

The problems continue to be on the import side. That is, until we do something about overall demand—I mean, Chairman Volcker pointed out that basically demand grew 2 percent faster than the ability of the economy to supply it, and until that happens imports will continue to grow at a fairly rapid rate.

I think on the export side we can probably look forward to a fairly good performance.

Senator MATHIAS. Thank you.

Mr. Rohr.

Commissioner ROHR. Mr. Chairman, I think I would agree with virtually everything my colleague just stated. I do not know whether exports are going to come roaring back into the world market, but it seems to me the sustained recovery that we have in the United States has been a very important factor as to what is going to happen in the rest of the world.

There has been an obvious lag in recovery of other countries, some of our major markets, but they seem to be turning the corner and I think certainly within the next 2 years we will see a gradual reopening of those markets to our goods.

I too have a very firm belief in the competitive nature of American business. In my current position, I have had the opportunity to visit a number of industries around the country. Very frankly, I am impressed to see widspread use of advanced technologies and cost-saving management techniques which create new efficiencies and enable producers to become more competitive. So I am more optimistic.

Mr. MENDELOWITZ. Let me say that I think the combination of the fact that growing income overseas will increase the demand for U.S. products, coupled with what I think is a very positive improvement in the competitiveness of U.S. industry coming out of the recession, will contribute to better performance on the export side.

I think that this recession has been very deep, it has been very painful. The U.S. businessman has responded by making his operation leaner and more competitive and more efficient. I think that he is going to be a stronger performer on the world scene.

Mr. WETHINGTON. I would not disagree with the tone of optimism that has been expressed. But I think I would add one caveat to that, for no other reason than to spark a slightly different sentiment. I agree that our export posture will improve over the next 2 years, but we will face, I think, in the next decade and for a longer time a tremendous competition from a number of countries globally.

It will be competition that will be there apart from currency exchanges, apart from our own domestic readjustment which I think will take place. But there are tremendous competitors on the world scene, about which we cannot be complacent.

It is not only industrialized countries, but it also includes advanced developing countries, particularly those in East Asia: the Korea's of the world, Taiwan, Singapore, and others. They are tremendous competitors. It is a situation that will require us not to be complacent. It is a situation in which businessmen first and foremost must show long-term commitment to exporting.

Exporting now is no longer a matter of individual profits, of individual companies, but we believe it is a matter of national necessity, because our domestic economic well-being is so intimately tied to how well we do in foreign markets. The competition will get tougher. I think we can meet it, but it will demand a long-term commitment from U.S. business to get out there and to do the necessary marketing, the necessary long-term spade work, building the infrastructure that is going to make us competitive in foreign markets.

Senator MATHIAS. Mr. Rohr, you mention some of the procedural protections that are available under present law. It seems plausible that protection given to industries under section 201, especially to primary and intermediate materials, would increase the difficulty of American manufacturers who are dependent on those materials to compete against imports.

Is that a reasonable deduction?

Commissioner ROHR. Mr. Chairman, there can most certainly be some downstream effects on industries that do depend on materials from industries who receive protection under any of the trade laws. Let us just take copper for a moment as an example. Yesterday the Trade Commission found unanimously that imports were a serious cause of injury to the domestic copper industry.

Under the statute, we are directed to devise a form of remedy that we will recommend to the President. If the President puts into effect some form of relief, that particular relief we recommend, or something else, it is entirely conceivable that the price of refined copper in the United States would rise.

As a matter of fact, the domestic industry in their testimony before us, assuming the quota level that they have requested would be put into effect, I estimated an increase in the price of 5 or 6 cents a pound for refined copper. This indeed means an increase, obviously, in the price of refined copper to those industries in the country which produce fabricated copper products.

The question that section 201 goes to as intended by the Congress is the protection of domestic resources that are impacted substantially by imports. I think it is very obvious that whenever we protect production in this country by trade barriers, there is a factor there that will impact upon consumers of the particular downstream product. There is no way to get around that.

But the intent of Congress again, sir, as I understand the law, is to protect that domestic resource through temporary measures that will prevent or remedy the injury caused by imports.

Senator MATHIAS. What about the side effect of having a foreign producer seeing what is happening here, jumping over the wall and sheltering behind it by investing and thus buying into our market? Do you observe any of that activity?

Commissioner ROHR. That is certainly always a possibility. I am trying to think of when that might have happened.

Senator MATHIAS. Maybe Mr. Wethington has had some opportunity.

Commissioner ROHR. I really cannot remember when that has happened as a result of the administration of the trade laws themselves.

Mr. WETHINGTON. If I understand the thrust of your question, Senator, it is have we seen instances where foreigners have made direct investments domestically as a way of dealing with what otherwise would be an import problem.

The obvious situation that comes to mind is autos. We have seen, not only in Tennessee but in California and other places, a significant investment by Japanese companies. We also see it now in the steel industry with the proposed buy-in by Nippon Kokan of National.

We take the view that we ought to be open to direct foreign investment in this country, that it both creates jobs and in many instances can improve the economic base. So we do not wish in any way to discourage this kind of investment, but we take an open policy toward it.

Senator MATHIAS. And you do not feel that that offsets the benefits of the procedural protections?

Mr. WETHINGTON. I do not know what the alternatives are. It may to some extent offset these.

Senator MATHIAS. I am not asserting as a personal view that it does. I am just asking.

Mr. WETHINGTON. I am trying to think of some instance where we have seen this as a direct result of an actual case. I guess in the theoretical sense it may to some extent offset the benefits of protection, but there may be instances where we derive through direct foreign investment lower cost of production benefits in the economy as a whole, and so I am not sure I would necessarily draw the conclusion that it is offset.

Senator MATHIAS. Mr. Rohr, if we apply existing section 201 procedures to major imports, we are likely to get a demand for compensation from our trading partners, are we not?

Commissioner ROHR. Mr. Chairman, I must confess that as I was making my vote on steel this last week I was thinking about the possible effects of our vote perhaps on our agriculture industry, because under article 19 of the GATT, which is the international rule that mirrors section 201, or section 201 mirrors it, a country can demand compensation. And I would think that if our steel decision has an adverse effect on Europe, everything else being equal, perhaps the Europeans might look toward the agriculture sector for some compensation.

Senator MATHIAS. So the effect of that is to shift the cost of protection to other parts of the economy.

Commissioner ROHR. It is a theoretical possibility, yes, sir.

Senator MATHIAS. Mr. Mendelowitz looks as though he thinks it may be more than theoretical.

Commissioner ROHR. Well, it does not necessarily have to happen.

Mr. MENDELOWITZ. It does not necessarily have to happen. If it does happen, what we will in a sense be doing is penalizing our most competitive industries to help our less competitive industries. I think from an overall perspective we ought to think very carefully about whether that is in our long-run interest.

Senator MATHIAS. In dealing with some of our own problems, we have shown more imagination than perhaps is available under section 201. In the Chrysler case we imposed a whole range of conditions on Chrysler in order to give them an opportunity to survive. In section 201, we look to keeping industries alive, to helping industries survive, but we do it with a very narrow range of actions—the ending of quotas or scheduled reductions of tariffs to induce the protected industry to make the effort to become competitive.

Would it be of value if the Congress amended the trade laws to authorize the imposition of more conditions or more flexible conditions to industries that are granted protections?

Mr. WETHINGTON. The present 201 statute does require, if I read it correctly, that the International Trade Commission, as well as the President when he considers a recommendation from the ITC, to take into consideration in determining whether relief is appropriate in the particular case the steps which industry is willing to take to adjust to the import situation.

It is the view of the administration that that provision as it now stands is adequate, and I think many of us will be looking with some interest to see how the ITC in the two recent cases applies that particular requirement.

Mr. MENDELOWITZ. I think that your question is an absolutely fascinating question and I think it is at the heart of the safeguard or 201 relief type actions, namely, to what extent should we require more from the private sector when they are given relief under a 201 action?

From my perspective, I view the use of import relief to provide assistance to an industry as essentially equivalent to the provision of any other form of Government subsidy, whether it be a direct Treasury check, a loan guarantee as in the case of the Chrysler

program, or an import quota that generates additional revenue for the industry in question. And I think that the Chrysler example needs to be looked at very carefully to establish whether there are lessons that can be learned that are applicable to the 201-type actions.

Several years back we looked at the adjustment under the 201 program and we found that for the most part there really was very little adjustment that took place. When you are talking about an industry like the steel industry, which is covered by the 201 injury decision a couple days ago, you are dealing with a major employer, a major industry, major impact on the economy. And what happens in that industry if it were to receive protection under 201 I think is really quite important for the health of our economy and the general direction of our economy.

The Chrysler parallel is really fascinating. What we have in Chrysler I think is a number of interesting aspects. One of them was that, while the U.S. Government was prepared to provide a loan guarantee, that loan guarantee was conditioned on the provision of assistance to the corporation by all of the constituent groups that would gain if Chrysler were to survive as a corporate entity.

And that means that Chrysler's workers took wage rollbacks, cities and States where Chrysler's plants were located provided low-cost loans to the corporation, management took reductions in salary, creditors made interest rate concessions and converted debt into equity, and shareholders made contributions in several forms. One was the fact that the corporation gave the Government warrants which substantially diluted the capital of the shareholders.

Second, the corporation was required to spin off assets to generate revenues for investment in the automaking part of the corporation.

Furthermore, in order for Government assistance to be effective, I think that you need to make sure that there is enough revenue to do the job, and you need to make sure that in fact that revenue gets used in a way to achieve your policy objective.

If you are going to provide assistance for the steel industry, I think the objective should be to make that industry a healthy competitor down the road so it can compete without protection after the period of relief. And I think that in return for that protection we should have a fairly stringent level of requirements placed on the industry in terms of operating plans, investment plans, and contributions by constituent groups to help that turn around.

Mr. FEKETEKUTY. Mr. Chairman, I agree that section 201 as currently written gives us all the authority that we need in order to levy requirements on the industries benefiting from relief. The question has always been the extent to which those provisions have been used.

I think we might argue that perhaps in the past we may not have made as good use of those provisions as we might have. I do detect a growing sentiment both within the administration and outside the administration to try to move more in that direction, to try to create more of a process where there can be a joint effort undertaken between the Government and the various private sector groups.

In my mind there clearly is a need for further public consensus-building as to exactly what it is that we should expect. As part of that process, it seems to me the Congress can make a useful contribution in trying to develop this consensus.

I would want to point, in this respect, to draft legislation that Senator Heinz has been discussing. Without saying at this point whether we would support or not support Senator Heinz' legislation, discussion of legislation of that kind can be very useful in moving public consensus in the direction that Mr. Mendelowitz discussed.

Thank you.

Senator MATHIAS. Thank you.

Mr. Rohr.

Commissioner ROHR. Mr. Chairman, if I could make perhaps one correction for the record. I think perhaps I understood Mr. Wethington as saying that both the Commission and the President take into account what the industry would do with relief in determining what that relief might be. That is not quite the case with the Commission. The law tells us that, once we have decided—once we have found that there is serious injury from imports, we must fashion a remedy that is simply sufficient to prevent or remedy that injurious element.

Personally, I will be very interested in what the industry can tell us. For example, the steel industry; next week when we hold a remedy hearing, I will be interested to hear what they will do with relief. But that is not necessarily a factor that under law we must take into consideration.

There is not any industrial recovery plan or development plan or anything like that that is required by law at this point. That is an element that I can consider, but I do not necessarily have to.

Senator MATHIAS. Mr. Wethington, did you have a comment?

Mr. WETHINGTON. I just want to say, on the question of the extent to which adjustment is a consideration in the decision to provide relief, I think certainly the present provision in the 201 bill should not be a dead letter, but it should be an element that is looked at.

There are limits on the extent to which I think Government can become intimately involved in the adjustment process of industry. The Government simply, in my view, does not have the wisdom, nor the bureaucratic capacity, to make certain detailed judgments as to the adjustment process of particular industries. We should not be involved in questions such as which plant to close or which technologies to apply, all of which are important considerations, perhaps, in answering the question of what must the industry do to take advantage of important breathing space, which is sometimes appropriate breathing space, from imports.

So I would stress that there are limits, there are limits to which the factor of adjustment should appropriately be required, and limits to which the Government can go to oversee it or implement it.

Senator MATHIAS. Thank you.

Mr. Mendelowitz.

Mr. MENDELOWITZ. I think the issue of requiring adjustment or requiring contributions by constituent groups, such as labor, credi-

tors, and others who stand to gain from a turnaround, has a lot of benefits. One is that it provides a multiplier effect with respect to the assistance provided by Government action. Not only does the industry benefit from the increased revenue associated with the trade measure or whatever is taken, but they also benefit by the increased cash flow and resources associated with all of the contributions from the constituent groups.

Second, there is an equity consideration. Asking for trade relief or protection from imports without having to contribute something makes the cost of that protection for those who benefit essentially zero. The equity consideration of an adjustment plan that has contributions by constituent groups is that those who stand to gain the most also make a specific contribution to the turnaround of the health and competitiveness of the industry.

The third, as Mr. Wethington pointed out, is I think that generally speaking most industries do not like to have the Government looking over their shoulder. Having an adjustment plan, commitments that have to be adhered to, contributions by constituent groups, provides a set of incentives for those who directly benefit from the trade relief to get out from under both the Government looking over their shoulder and from the trade relief.

And I think that the Chrysler parallel holds here in two respects. One, the Government did not tell Chrysler what plants to open, or what plants to close. The running of the company was left up to the corporate management. All the Government did do with respect to these activities was to review and accept plans from the company that showed what the forward product plans were, what the market penetration was assumed to be, what the capacity was going to be—all sorts of other information about the way the corporation ran. We dealt from the Government side at a much more macrolevel and had no role to play in the decisions about what plant to open up or what plant to close, so that Government does not get involved in detailed corporate decisionmaking on those matters.

Second, based on the pronouncements by Chairman Iacocca of the Chrysler Corp., I would say that the incentives built into the Chrysler program that made it worthwhile to get out from under the benefit of the Federal loan guarantee worked quite well, because he said he was happy to pay off the loan guarantees as quickly as he could and get out from under Government oversight. So I think that is another parallel that holds based on the case that you raise in your question.

Senator MATHIAS. Well, I think maybe we have come to the point where we should take a break. We are very grateful to all of the members of the panel for being here. We will recess for lunch.

Dr. Beryl Sprinkel, the Under Secretary of the Treasury, will speak to the group at lunch, and I would hope, since we have the privilege of having such distinguished visitors in Baltimore today, that there would be some opportunity for personal exchange during the lunch hour.

We will stand in recess. The lunch will be served in the dining area, which is just immediately adjacent to the hearing room, and we will resume the formal testimony at 2 o'clock.

[Whereupon, at 12:10 p.m., the subcommittee recessed, to reconvene at 1 p.m. the same day.]

LUNCHEON SESSION

Senator MATHIAS. It is my great pleasure to welcome Beryl Sprinkel to Baltimore, indeed to Maryland. He labors under the handicap of having once been known as an economist. [Laughter.]

Of course, economists as a group are probably the most maligned class in America today. You remember that Harry Truman once said that he wanted a one-armed economist, so that he could not turn to him and say: "Well, Mr. Truman, on the one hand * * *, and then on the other hand * * *." [Laughter.] Thereby leaving the problem right in the President's lap, where it had started.

A more unkind comment that has been made about economists is that if you could lay all the economists of the world end to end, you should make sure that they stay there. [Laughter.]

Well, Beryl Sprinkel is one who has refused to stay there. Maybe one reason is because he was born in Missouri and, having been from Missouri, he demands to be shown. That is an extremely valuable attribute in any human being, but it is an absolutely essential attribute in an economist.

He has been doing interesting things throughout his career. One of the most intriguing was his founding of what was known as the Shadow Open Market Committee, which I presume had as its purpose keeping the real Open Market Committee at the Federal Reserve Board honest and on the right track by occasional public reminders of the true course as the Shadow Committee perceived the true course to be.

He has just come back from London, where he sat with President Reagan at the economic summit. He has been the Under Secretary of the Treasury since 1981, and before that he was executive vice president and economist at the Harris Trust & Savings Bank in Chicago.

He brings to this meeting, and to the seminar that we are conducting here for the next several days, extraordinary credentials. He is eminently qualified to speak on the subject of what debt means, the effect of developing country debt on U.S. trade prospects, and, perhaps most importantly of all, of the U.S. strategy for dealing with the problem.

So it is an honor for me and a personal pleasure to introduce Beryl Sprinkel, Under Secretary of the Treasury. [Applause.]

STATEMENT OF DR. BERYL SPRINKEL, UNDER SECRETARY OF THE TREASURY

Mr. SPRINKEL. Thank you very much. Senator Mathias, ladies and gentlemen, it is a pleasure to be here in Baltimore. I am told that the only thing hotter than Baltimore in the summer is the Orioles, unless it is Washington. We have had a streak of it lately.

But I do not get here very often, and that is my loss, because we are really not very far away. And nowadays when my wife kisses me goodbye in the morning, she usually hands me my American Express card, because she says, with the traveling I have been doing, I cannot leave home without it. I recently left for a 2-day

trip to Honolulu and came back 3 weeks later, so she knows what she is talking about.

I have been to Japan three times in the past 3 months, Rome, London twice, and Paris, not to mention a few exotic spots in the U.S. like Chicago, my hometown, and Honolulu. It is no wonder I look like I do. You should have seen me before I joined the Treasury Department. I looked very much like Robert Redford—you would not believe that—before the jet lag took over.

I would like to tell you what all that traveling has accomplished, besides being broadening, because in today's world the economic situation in one country has a very wide-ranging impact on all of the others. We are now, more than ever, linked to the economic well-being of other nations.

Last week, as mentioned, President Reagan attended not only the summit, but also the 40th anniversary of the invasion of Normandy. The London summit actually started the next day. I am told that the summit leaders were deeply moved by the memory of the sacrifices that free men have made to sustain freedom, and their reaction to the D-day anniversary set a tone for their subsequent deliberations.

I recently ran across a remark by President Roosevelt, made shortly after the D-day invasion in 1944, which I think is appropriate to this occasion:

> During the nineteenth century, during that era of expansion on this continent, we felt a natural isolation—geographic, economic, and political—an isolation from the vast world overseas. Not until this generation have people been compelled to widen the orbit of their vision to include every part of the world.

Certainly President Roosevelt's words ring true today. The meetings that I have attended in these past months, including the London summit, demonstrate once again the mutual benefit of widening our orbit and recognizing that when barriers to commerce break down so too do political barriers.

We have led the movement in industrial countries to build an economic recovery based on noninflationary policies. When President Reagan presented this strategy to the Ottawa summit in 1981—I was there and I heard him say it—he predicted low inflation, high growth, and rising employment. For some summit countries, what the President proposed was a very radical shift, but the result has been improved convergence of economic performance in most of the summit countries, with one or two exceptions, and indeed around the world.

President Reagan is getting a lot of the credit from the summit leaders, who recognize that his policies have resulted in a healthy U.S. economy, characterized by a strong recovery, stable noninflationary growth, and job creation.

We saw consensus at the summit, for example—and if this sounds like Reaganomics—we did not dare call it that—it is not an accident—that money growth must be stable, moderate and predictable; that public sector spending needs to be reduced to free resources for investment; budget deficits need to be reduced by spending cuts, policy-induced obstacles to change need to be removed so resources can flow in response to market forces—a good example is the recent yen-dollar agreement that I had the pleasure of working on—and a new understanding of the short- and long-term results of

the President's deficit reduction plan, and a remarkable degree of consensus on the international debt situation.

As I have already pointed out, the economic well-being of the U.S. economy is dependent in part upon the health of the Mexican economy, the Brazilian economy, and that of other debtor nations. U.S. exporters were directly affected when developing countries were compelled to cut back on imports in order to service escalating debt obligations. U.S. exports to Mexico, for example, declined by 48 percent between 1981 and 1983, a decline of $8.7 billion.

Let me also mention briefly another international financial issue which has caused concern for U.S. business, particularly exporters—the appreciation of the dollar over the past 3 years. I am afraid I am not going to be able to predict for you where the dollar will be in relation to the other major currencies over the next 12 months. I do not know; neither does anyone else. But I will discuss the factors I believe have had and will continue to have an influence on the relative value of the dollar. But before I plunge into the icy waters of explaining exchange rate movements, a subject that is only passably fit for a luncheon discussion, I would like to discuss the present international strategy for dealing with the debtor nations and how agreements reached at the London summit will affect that strategy and I believe improve it.

Just 2 years ago, the debt problem of the developing countries appeared to many observers to be unmanageable. Well, we have come a long way. Developing country debt problems are by no means over, but we do have mechanisms in place for addressing the problems and we are beginning to see results.

Mexico is the most notable success. Brazil has also made progress. These two countries have IMF adjustment programs in place and are effectively attacking the major distortions plaguing their economies.

This type of progress has not been uniform throughout the developing world. Many countries are just now beginning to implement IMF adjustment programs. Others are in the process of negotiating agreements with the Fund. At present 34 countries have IMF arrangements and 13 others are in the process of negotiation. There are many developing countries that did not get into difficulty in the first place. Most of them are located, as you well know, in the Far East.

The leaders at the recent London summit pledged to continue the present case-by-case approach with respect to debt problems. In addition, in recognition of the significant progress made by some countries, especially those mentioned and a few others, there was agreement by the summit participants that governments should encourage commercial banks to negotiate multiyear reschedulings with such countries.

This does not mean that in the future the United States or any other government will sit down at the negotiating table with the private banks and their customers. It is merely a recognition that the private market rewards good performance. Governments themselves will consider multiyear reschedulings of official debt where appropriate.

Adjustment by the developing countries is the most important precondition for a resolution of debt problems. Disciplined and

market-oriented policies are a precondition for achieving stable satisfactory growth with a sustainable balance of payments position.

Changes affecting the traded goods sector are especially important. There is considerable evidence that developing countries with relatively open trade regimes have higher growth rates and are better able to withstand external shocks than those following import substitution policies. Open trading regimes are those which encourage flexible exchange rates, liberalization or simplification of import restrictions, and the removal of other obstacles to efficient resource allocation, particularly obstacles affecting exports. Unfortunately, export subsidies, overvalued exchange rates, and administrative controls are still widespread in some developing countries, causing distortion to their economic systems.

The United States has encouraged less developed countries to adopt open trade policies, both in our bilateral meetings with representatives of the developing countries and in multilateral meetings.

One theme which we have pushed and will continue to push especially strongly in the weeks and months ahead, and which was endorsed at the London summit, is the positive role which investment flows can help play in the LDC adjustment process. Foreign direct investment can substitute for and complement private and official loans. However, there is a tendency on the part of developing countries to place conditions on foreign investors which either distort investment flows or even in some cases discourage them altogether.

This administration is not blind to the temporary sacrifice that adjustment programs often entail for the developing countries involved. However, adjustment programs represent the best opportunity for restoring growth and access to credit. Again, Mexico is a prime example. After a 5-percent decline in its GNP in 1983, the real GNP is expected to grow moderately this year. Imports are expected to rise from $7 billion in 1983 to something in the $11 billion to $13 billion range this year. Already in the first 4 months of 1984, U.S. exports to Mexico are up 35 percent compared with the same period last year.

U.S. exports to the major debtors as a whole increased by 10 percent in the same time period. As other developing countries achieve success with their adjustment plans, we expect a small but steady increase in U.S. exports.

The International Monetary Fund plays an indispensable role in helping countries which have run into debt difficulties create the conditions for the resumption of growth and development. I am concerned that the Fund's role in promoting growth and trade is frequently misunderstood. They are getting a bum rap.

There seems to be a widespread mistaken belief that "economic adjustment" in the Fund's parlance means the acceptance of unnecessary domestic austerity; that somehow, were it not for the bad luck of encountering payments crises, these countries would have been able to continue to grow and import indefinitely at previous levels.

For most countries with payments problems, a decline in growth and imports has occurred before the Fund came on the scene. For these countries, the IMF's financing necessarily provides time for

the country to implement needed adjustment measures at a higher level of imports and growth than would be possible without the Fund. Moreover, the existence of a Fund program acts as a catalyst for private sector finance, making possible an even higher level of imports.

Adjustment may require some degree of temporary austerity. The degree of such austerity depends on the extent to which previous domestic policies departed from a sustainable path.

Another important element of our debt strategy entails economic recovery by the industrialized countries and the maintenance by these same countries of open markets for goods from the developing countries. Both are important for export growth by the high debt countries.

The worldwide recovery is already having a favorable impact on LDC exports. The United States again leads the pack. Our growth is pulling in imports from both the developing countries and some of the developed countries. The U.S. recovery has already spurred a $4.5 billion increase—12 percent—in imports from the seven major developing country debtors in 1983.

The figures for the beginning of 1984 are almost unbelievable. I had to have them rechecked. U.S. imports from these countries were up by $4.1 billion—33⅓ percent—in the first 4 months of 1984 as compared to the same period a year earlier. Thus, in just the first 4 months of 1984 the amount of increased imports that the United States has pulled in from the major debtor nations is almost as much as the amount of the total increase in our imports from these countries from 1982 to 1983. This growth has been accounted for not only by increased volume, but also by a significant firming in some commodity prices.

So far European growth has not been as dynamic as in the United States, although growth definitely is occurring there. Treasury estimates that aggregate growth in the European Community countries will be 2½ to 3 percent in 1984 and 1985, with some variation—France and Italy growing much slower and some other countries more quickly. Partially because of their less dynamic growth, the Europeans have thus far not pulled in developing exports to the extent that the United States has. But we expect European imports to pick up later this year.

As the recovery in the industrialized countries is important for the export growth prospects of developing countries, so is confidence that the market will remain open. An open trading system enhances growth and employment prospects in both developed and developing countries.

The recent rise in interest rates is a cause for concern. However, we have calculated that the effect of increased growth in the industrialized world should outweigh the interest rate effects that have been obvious so far. We estimate that for every 1 percentage point increase in the LIBOR rate, the seven largest debtors must pay an additional net $2.1 billion, which is not insignificant. Based on trends for the first few months of this year for the seven major debtors, any expected increase in average interest rates in 1984 will be more than offset by increased exports to these seven countries.

I know that many of you are concerned about the trade deficit and specifically the impact of the strength of the dollar on U.S. trade. The trade deficit is indeed large, both in absolute terms and in relation to our GNP. Last year's deficit was $61 billion and this year's will exceed $100 billion.

There can be no question that the strength of the dollar makes life more difficult for firms in the traded goods industries. However, our analysis of the causes of the trade deficit and of the strength of the dollar indicates that there are no policy actions which should or could be taken which would not do more harm than good to the U.S. economy.

Dollar appreciation is only one factor behind the widening of our trade deficit. To begin with, as I have stated, developing country debt problems have contributed to a decline in U.S. exports, accounting for about $25 to $30 billion of the widening of the deficit between 1981 and 1984. Second, the strength and timing of the U.S. recovery relative to our trading partners is also a major factor behind the trade deficit, accounting for another $25 to $30 billion. Although the strength of the dollar is clearly an important influence, there is no reliable measure of its size, and I have seen estimates ranging all the way from $25 billion at the low side to as high as $100 billion.

There are many who argue that, regardless of how large or how small the impact of dollar appreciation actually is, it has been artificial and unhealthy, brought about by an excessive U.S. budget deficit and high U.S. interest rates. You might have even heard other speakers today say that. The facts simply do not support this view. On balance, over the last 3 years the dollar appreciated against all major currencies. Yet, interest rate differentials moved against the dollar; also interest rates in the U.S. declined.

A more meaningful argument can be made linking real interest rate differentials and a strong dollar, but work we have done at Treasury suggests that there has been very little correlation between real interest rates or real interest rate spreads and exchange rates.

More fundamentally, the appreciation of the dollar over 3½ years reflects the normal working of the adjustment process as international investors have reacted to their perception of where rates of return will be highest, where they will be most secure. While I cannot tell you the exact significance of each factor affecting those perceptions, I can point to the most important of them: the fundamentally better U.S. economic performance and prospects compared to any other major country in the world, including sharply reduced U.S. inflation, weaker performance and prospects in other major industrialized countries, and the threat posed by economic and political turmoil in the Middle East, Latin America, and Eastern Europe.

Under those circumstances, keeping the dollar from appreciating would have required us to pursue unsound inflationary domestic policies, to weaken the U.S. economy to match the rest of the world. That is not the reason I came to Washington and I do not think it is the kind of policy that you would prefer, either.

We also do not feel it is appropriate now to change U.S. international economic policies to address the trade deficit. You will notice

there is no "On the one hand or on the other hand." I am telling it straight down the middle, OK Mac?

Senator MATHIAS. I hear you. [Laughter.]

Mr. SPRINKEL. Some of the measures which are urged on us are impractical or even counterproductive. These include exchange market intervention—that is, price fixing—in an attempt to drive down the dollar's exchange market value, capital controls, a massive tax increase, and a tightening of U.S. trade restrictions, or implementation of export subsidy programs. I have heard all of those proposals.

Several of the factors which are pushing the dollar up are beginning to shift. Moreover, at some point currency depreciation in response to the widening current account deficit must assert itself as a normal part of the adjustment process. Over time, dollar depreciation should help to moderate both U.S. trade and current account deficits and foreign surpluses, but it is not going to happen quickly.

In conclusion, I would like to leave you on a note of cautious optimism. That there will continue to be problems with individual debtor countries in the period ahead is absolutely certain. However, we have a strategy for dealing with these problems. It is an internationally agreed upon strategy, with a proven track record. Moreover, the summit countries agreed at London to strengthen the strategy to take account of successful adjustment efforts.

Countries such as Brazil and Mexico are adjusting in line with this strategy. Many others, including Korea, Morocco, and Turkey, also are making progress. This is good news, not only for these countries but for the world financial and trading system, and it is also good news for U.S. exporters.

Responsibility for sustained progress in this area lies both in the developing and developed countries. The developed countries need to maintain or develop rational adjustment plans which include liberalization of the trade and investment sectors.

The industrialized countries for their part need to ensure that the recovery proceeds apace and that it is sustained and that their markets stay open, particularly for the products of the developing countries. Further liberalization by all countries will help to set the stage for steady world growth, which is what we all want.

Commercial banks should consider negotiating multiyear reschedulings with those countries which have adopted and are successfully implementing appropriate adjustment policies. I am talking about successful performance. Finally, the international trade and financial institutions must continue to play a very key role.

To conclude, we are certain there are no quick fixes, but we are convinced that our medium-term policy focus on both domestic and international issues is intact and will continue to yield positive benefits in the months ahead.

Thank you very much.

[Applause.]

Senator MATHIAS. Thank you very much, Mr. Secretary.

I hope you all enjoy your lunch, and we will resume in the auditorium at 2 o'clock. Thank you.

[Whereupon, at 1:35 p.m., the meeting was recessed, to reconvene at 2 p.m. the same day.]

AFTERNOON SESSION

Senator MATHIAS. The committee will come to order.

It is important that the committee have the opinions and views of the people who are most immediately impacted, and so we welcome today two witnesses who will give us the benefit of their experience under current conditions: John Renneburg, president of Edward Renneburg & Sons; and Eugene Stastny, director of technology management of the Environmental Elements Corp.

Gentlemen, in what order would you like to testify?

Mr. RENNEBURG. We could toss for it.

Senator MATHIAS. Well, I will leave that decision for you.

STATEMENT OF JOHN N. RENNEBURG, PRESIDENT, EDWARD RENNEBURG & SONS, BALTIMORE, MD

Mr. RENNEBURG. Why do I not begin.

Mr. Chairman, we are delighted to be here. I think little fellows like our company are not often heard in public, especially with distinguished Senators or by distinguished Senators. I would like to cover a few things: our company background and products, and the problems we have had in selling overseas, and what perhaps the Government can do to help us.

Actually, we are a very small company, with less than 100 employees, although we have been operating here continuously in the Port of Baltimore for over 110 years, and we have been designing and manufacturing specialized solid processing machinery, principally for the fishmeal and oil industry, granular fertilizer, food processing, metals and metalurgical, a little bit for petrochemicals, rendering and tobacco industries.

And during these years we have pioneered much of the basic technology that has been used around the world. In some cases we have had patents for converting, for example, nonedible fish and fisheries products, such as menhaden and even whales in the old days, into edible products.

One reason I might mention in this respect why the chickens that we eat these days are so tender is because they put a small percentage of fishmeal and fish solubles in, which have tremendous growth factors, permitting 8 weeks growth on chicks in about 6 weeks. So the Delmarva broiler industry and around the world all benefit from the sea in this respect.

In addition to fishmeal, the other major product of the fish reduction industry, is fish oil which is used industrially and in cosmetics—lipstick has a lot of herring oil in it, for example, but does not taste "fishy."

They also make edible margarines out of fish oil. Curiously enough, the Pure Food and Drug Administration will not allow us to use the fish oil produced in the United States for edible margarine. So the menhaden industry, for example, ships it to Europe, where they refine it and ship it back to the United States as margarine.

While our equipment is large and expensive to ship, the fish reduction industry is a small specialty, but it is a very important one in the world. Our equipment is used throughout the Atlantic coast from Newfoundland and Labrador down to the gulf, and from Alaska to Mexico. It is used in Norway, Denmark, Turkey, Morocco, southwest Africa, Panama, Bolivia, Peru, Chile, Brazil, Hawaii, Samoa, Japan, and the Soviet Union.

Our second major product group is machinery for producing for high analysis chemical granular fertilizers, which is also of worldwide importance. And we have equipped many of the plants in the United States and we have been very active all over the world. We put in equipment in three plants in India. We have sold some in Jordan, quite a bit in Korea, and other parts of the world, producing NPK fertilizers and various other types of plant foods.

We have tried to roll with the punches as business has gotten bad over the years, and we have been through many, many cycles. I have been connected with the company for over 40 years. I remember my father during World War I, when I was scarcely kneehigh to a grasshopper, talking about how he was so excited because they were taking kelp on the west coast and making munitions out of it.

Now we are taking Irish moss and kelp and making thickenings for ice cream and milk shakes. We have plants, furnished equipment for making baby foods in Australia and Great Britain.

But perhaps our most interesting job recently has been converting animal bones and meat meal into photographic gelatin. I was coming back from India a few years ago and stopped by Belgium to see how our equipment was working and I saw this tremendous pile of animal bones, the largest and the cleanest bones I had ever seen in my life.

I asked Jacques Belliere, the chairman of the board: Jacques, where do you get these bones? And he said: Oh, they are the bones from the sacred animals of India. We convert them here in our plant through your equipment, and then it goes to Eastman Kodak in Rochester, NY, and makes excellent photographic film. And I thought that was rather unusual.

But over the years, the next part of the problem—that is enough background on our little company. I want to talk a little bit about the problems of selling overseas. Years ago it was not that much of a problem. We had very unusual and unique products, as we still do. Everything was sold 25 percent with the order and the balance by means of an irrevocable letter of credit with local banks or New York banks, and that went along just fine for many, many years.

But in the 1960's and 1970's, when we were getting very active down in Chile and Peru, our Norwegian, German, and Danish competitors were coming in and offering 8- and 10-year credit terms. So we were trying to sell our old way and we finally found we were getting nowhere.

So we went to our banks and we went to the Export-Import Bank and they said, well, they would stretch it and give us 3 years. So I went down and sold the first plant down there, and we had equipment going eventually in 37 plants. And the head of the plant, after negotiating from 9 in the morning until 11:30 at night, and he finally had a couple of scotches and he grabbed me by the collar

and he said, John, why can you not give us 10-year credit terms? And I felt like saying, I am not sure Peru or Chile would be around 10 years and I wasn't sure we would be, either.

But at any rate, we went back to the Export-Import Bank finally getting 5-year credit terms, and then we sold quite a bit of equipment and that helped us a great deal. A little later, we also negotiated to sell equipment to some plants in Turkey, and put in three fishmeal plants over there, again using 5-year credit terms.

But when we wanted to get more help in selling our fertilizer equipment, we had to go to the World Bank. And if it had not been for the help of those institutions, we would have been literally pushed out of world markets, I am sorry to say.

But at any rate, more recently the terms have been extended by our competitors over there, and to make it more difficult for us American manufacturers, Norwegian competition will go to their government and say, we need certain improved equipment, and the government would ask, how much money do you need? And they reply, well, so many hundreds of thousands of dollars of equipment, or half a million dollars, and the government would grant them the money, so they could develop it.

And instead of making them pay it back, my understanding is they develop it and then they can sell it on world markets and the Norwegian Government says this is great because now we are stimulating foreign trade.

We have never had that opportunity to get funds from the Government and we do not want it, but it certainly puts us in a poor position and makes it very, very difficult at times to compete with these types of situations.

I want to talk a little bit now about what the Government might be able to do to help. These are just my ideas. I have felt—at the end of World War II when I got out of the Navy and got back into industry again, our company had been working hard on defense products and we found that our equipment was getting badly worn, as was also the case in many of the war industries which had been working around-the-clock.

And of course, they talked about the Marshall plan, which everybody thought was excellent, and I had the feeling that some day it is going to boomerang, because if they would only take the old equipment that was in the aircraft plants and the shipyards and the smaller American industries and send those worn machine tools to Europe and to the Far East and all those areas and let them rebuild, and give us the latest equipment or make it possible for us to modernize, we could have continued the technological lead that we had.

But we are still struggling with fairly old machine tools, although we have done as much retooling as we could. I was interested, even as recently as 10 or 12 years ago when we were having some very heavy steel rolled in Bethlehem Steel Co.'s shops here for a job in India and when was beyond our capacity to roll. It was about an inch and a half or 2 inches thick. We could only roll 1-inch thick steel.

And I looked at this old set of bending rolls which was a vertical machine, and I said: My goodness, it looks like it came out of the Ark. Oh, they said, it was made in about 1893 here and we are still

using it. And this was at the Bethlehem Steel Shipyard 10 or 12 years ago. It is very unfortunate.

But now, of course, everything changes. The latest technology is coming into play. Industry is going to pick up again, and I am very encouraged and I appreciate your bringing this group of economists and people here today, because it was excellent to hear the optimism.

I feel optimistic. The only problem, of course, is that heavy industry is still lagging far behind the economy. While we are a little busy at the moment, I worry 6 months and a year down the road, and actually do not see any plant expansions requiring major capital equipment in the offing. The people in Europe are still depressed. They are behind us, apparently.

But we are struggling to keep going and keep everybody on the payroll, and we are working hard. And I think things are going to come along all right.

Getting back to the fertilizer industry, the world population is expanding, I am told, at the rate of about 200,000 people each day. So annual production of food has to increase and will increase, and that means more fertilizer equipment, hopefully, down the road, and it seems to me there should be a great deal more work in the next year on so.

For example, I had two people in my office yesterday who were interested in fishing for krill, which is part of marine plankton life down in the Antarctic. Apparently Antarctic krill are much richer in nutritional values than the Arctic krill, though why I do not know.

They said they had just come back from a survey down there and the Russian ships were all down there. I think they said there were 40 trawlers and they caught 350,000 tons of krill. And they said, this is something America has to get into.

And of course, this brings up another thing that has worried me over the years, because I have seen the New England fish industry, for example, just decrease and go to pieces. It is disgraceful. And yet, I have flown out over the fleets some years ago. This was just before we had the 200-mile limit, when we still had the 12-mile limit. You get out there beyond the 12-mile limit and it looks like Grand Central Station or 42d Street in New York at night.

There were Russians, Japanese, trawlers and mother ships, catching all the fish and siphoning them off. We had put in a plant, for example, the first Pacific hake plant, outside of Aberdeen, WA. The Russians came right up, siphoned the fish off the bottom. After about 3 years the plant had no more raw material to work on and went bankrupt.

I am so encouraged at this 200-mile limit. I believe it is going to help a great deal and I am so glad we were able to get it through by treaties or otherwise. It is going to help very much and, I believe, rejuvenate the New England industry if we can just get some help to finance some of these people.

As far as suggestions, we have helped the world, really, in their industrial potential with the Marshall plan. We are giving them all the military material that they need. I think we must now continue to emphasize humanitarian values by helping the underdeveloped nations pull up their standards of nutrition and life by cooper-

ative efforts, targeted to equip them with the appropriate means to do so. I think it is better than bullets.

So in conclusion, we believe that, in addition to further assistance from the Eximbank, which will make it easier for Americans to compete in the world, I think what is needed is perhaps a Government task force which can address small business problems in their global aspects. Maybe we have such, but I do not know of it.

Thank you very much.

[Mr. Renneburg's prepared statement follows:]

36-783 O—84——8

UNITED STATES SENATE
Committee on Foreign Relations
Hearings on June 15, 1984 in Baltimore, Maryland

TRADE ISSUES AND TRADE PROSPECTS FOR THE MID-ATLANTIC HEARINGS OF THE INTERNATIONAL ECONOMIC POLICY SUBCOMMITTEE
STATE COMMITTEE ON FOREIGN RELATIONS
PANEL III - INDUSTRY VIEWS ON TRADE POLICY ISSUES AS PRESENTED BY JOHN N. RENNEBURG, PRESIDENT OF EDW. RENNEBURG & SONS COMPANY AND ITS EXPORT SUBSIDIARY, RENNEBURG INTERNATIONAL INC.

COMPANY BACKGROUND AND PRODUCTS

A small Firm with less than 100 employees, the Renneburg Company has been operating continuously here in the Port of Baltimore for 110 years, designing and manufacturing highly specialized solids processing machinery for the chemical, granular fertilizer, fish meal and oil, food processing, metals and metallurgical, petrochemical, rendering and tobacco industries. During these years we have pioneered much of the basic technology and produced large Cookers, Presses, Dryers and Air Pollution Control Auxiliaries for the conversion of menhaden, herring, sardines, anchovies and other species of fish into fish meal, an important ingredient in animal and poultry feeds, and fish oil for use in cosmetics, edible margarine, insecticides, paints, synthetic rubber and other industrial products. Our equipment is being used along the Atlantic Coast from Labrador and Newfoundland to the Gulf, on the Pacific Coast from Alaska to Mexico, as well as in Iceland, Norway, Denmark, Turkey, Morocco, Southwest Africa, Panama, Bolivia, Peru, Chile, Brazil, Hawaii, Samoa, Japan and the Soviet Union.

Our second major product catagory consists of our granular chemical fertilizer equipment involving Continuous Combination Ammoniator-Granulators, Pug Mill Mixers and Reactors, Dryers and Coolers which we have sold throughout the United States, as well as to Plants in India, Korea, Iran, Jordan and other parts of the world to produce NPK fertilizers and various grades of plant

foods. Some of our other products convert Irish Moss and seaweeds into alginates for thickening ice cream and milk shakes, our canning machinery is being used to make baby foods in Australia and Great Britian, our special Presses and Dryers to convert animal bones in Sweden, Belgium and Germany for producing photographic gelatines and our reconstituted tobacco machinery is being used in France and in the Soviet Union. So we have had worldwide markets. Actually, we started exporting shortly after World War I aand have been doing it every since.

PROBLEMS IN SELLING OVERSEAS

Years ago practically all foreign sales were made on the basis of a 25% payment with the order, the balance to be covered by means of a confirmed, irrevocable Letter of Credit opened in our favor in a Baltimore or New York Bank payable against commercial invoices and bills of lading evidencing delivery of the equipment to the Carrier. However, in the 1960s and 1970s when we were selling equipment to 37 or so fish reduction plants in Chile and Peru, our Norwegian, Danish and German competitors were offering 8 to 10 year credit terms with very small down payments and 7 or 8% interest rates as I recall. After much effort, the EXIMBANK in Washington enabled us to offer 3 year credit terms and later extended 5 year credit terms after substantial down payments had been made and with interest rates several percentage points above our European competitors plus, of course, paying for commercial and political risk insurance. Throughout the 1970s we were able to struggle along in this way and equipped three Turkish Fish Reduction Plants in Fatsa Bay and Trabzon on the South Shore of the Black Sea to process 100,000 tons of anchovies which periodically arrive from the Soviet Union waters. Also, with the help of the World Bank we were successful in equipping three large granular fertilizer plants in India and a large fertilizer complex in Yosu, South Korea.

Up to this point, not only was our technology generally ahead of our European and Japanese "contemporaries", but as our raw material costs and wage rates escalated, outpacing those of our foreign competitors, it was becoming much more difficult to

compete. Moreover, the Norwegian, Danish and German Governments particularly were doing everything possible to help their manufacturers, paying for their research efforts and offering all sorts of incentives to sell overseas, as exports were their life blood. Therefore, we were beginning to lose jobs and without additional assistance from EXIMBANK we find it exceedingly difficult to compete, particularly at the present time with the strong U.S. Dollar as compared with other currencies.

WHAT THE U.S. GOVERNMENT CAN DO TO HELP

Although it was acclaimed as a great program at the time, in my view the problem started with the Marshall Plan at the end of World War II. Instead of our sending the latest technology and most modern machinery overseas to rehabilitate the war ravaged countries, including our former enemies, many of us argued at the time that the better course was to give them the older machine tools which had been used for many years in U.S. Plants, both large and small, and which were still workable, to enable them to get back on their feet; and for the Government to see to it by economic assistance or additional tax concessions that American Industry had the latest machine tools to keep us ahead technologically. We are still using some pre World War II machine tools and are fortunate if we can purchase a new machine tool every few years. Even 10 or 12 years ago when we were having Bethlehem Steel's Fabricating Shop at the Sparrows Point Shipyard here roll us some very heavy plate, they were using an old vertical plate roll reportedly made in 1893.

But now the latest products from automobiles to aircraft, from machine tools to process machinery made with the most modern equipment are flooding into our Country, the products of low paid, highly skilled labor and without the 38% additional cost of fringe benefits Ameerican Manufacturers pay. As the older equipment wears out, the demand for new machinery will again pickup - this is presently evident in the automobile industry, but it has been a long wait. Our foreign orders are now mostly for spare parts to keep machinery operational. So we have had to scurry into other areas in the domestic market place just to keep

our men working...but this is also being done overseas, I am informed, by component manufacturers of the Air Bus and by the declining shipyards in Hamburg, since the Germans can no longer compete with the shipyards in Korea, nor can we here in Baltimore at the Bethlehem Steel or Md. Drydock yards.

Yet with the world population expanding at the rate of 200,000 people each day, the annual production of food alone must rise by 50% or more if we are to sustain this growth. So over the next 20 years fertilizer production must increase by 100% and this means new fertilizer plant equipment to supply the farms with plant nutrients. It also means harvesting the fish and other resources of the sea to produce more fish meal and other protein rich products for animal and human consumption. Chemical fertilizers and fishery products are badly needed throughout the world and especially in the under developed third world countries. We also need to reduce our unfavorable balance of trade. But we cannot finance exports of such equipment in world markets with the keen foreign competition out there without more assistance from EXINBANK whose funds have in many respects been greatly curtailed. We must also reduce our huge Federal Deficit which could lower interest rates and enable American Maufacturers, large and small, to retool plants and forge ahead once again.

Whereas we have previously equipped many of these nations with industrial potential and military materiel, we can certainly now emphasize humanitarian values by helping the under developed nations pull up their standards of nutrition and life by cooperative efforts targeted to equip them with the appropriate means to do so...better than bullets.

Senator MATHIAS. Thank you very much, Mr. Renneburg.
Mr. Stastny.

STATEMENT OF EUGENE P. STASTNY, DIRECTOR, TECHNOLOGY MANAGEMENT, ENVIRONMENTAL ELEMENTS CORP., BALTIMORE, MD

Mr. STASTNY. Thank you, Senator. I have a prepared statement that I will work from.

My company, Environmental Elements Corp., is a Baltimore company of 470 employees, and as little as 3 years ago we had 830 employees. We are engaged in the design, manufacturing and constructing of systems for cleaning and handling of industrial process gases, the treatment of water, the control of sound, and the disposal of industrial sludges and hazardous wastes. Our sales for these environmental protection systems run annually from $75 to $100 million, of which $2 to $5 million represents export sales.

The majority of our export sales come primarily from customers who know our products and specifically include them or give them preference in their inquiries. In these instances, the price of the product is not the important consideration.

As a general overall observation, U.S. industry has enjoyed a domestic market second to none in the world, and this fact more than anything else has kept America from becoming a major international marketer. While in the past the United States enjoyed the largest dollar volume of exports compared to other industrial countries, these exports represented less than 10 percent of GNP as compared to 30, 40, or 60 percent in some cases of other industrialized countries.

Most foreign business enjoyed by American companies was because American-made products were wanted, not because we were really out there hustling for sales. The vast majority of American industry in my opinion has yet to learn how to compete effectively in export sales.

When my company is offering what we call mature products, and when we are competing toe to toe with international competitors of proven capabilities, we find ourselves noncompetitive for a number of reasons.

So that you better understand the nature of our products, we offer electrostatic precipitators for cleaning the exhaust gases from industrial smoke stacks. That is one of our products. These precipitators are fabricated from carbon steel.

They cost from $2 to $10 million. They each weigh from 300 to 1,000 tons. They are fabricated of carbon steel and can be 50 feet high, 50 feet long, and as much as 40 to 150 feet wide. So you see, we are talking about large pieces of industrial equipment that requires more or less local fabrication.

Most industrial developed countries have five to six suppliers of such devices, and making a sale into an industrialized country based on exporting from the United States we find is virtually impossible. Our exports are burdened with higher labor costs, high value of the U.S. dollar, packing and shipping charges, and customer favoritism for indigenous suppliers, all of which make our exporting to these countries extremely difficult.

Therefore, for the industrial countries of the world, we license our know-how on a long-term basis and we settle for royalties and some sales of special components. The majority of my time is devoted to establishing licensees worldwide. We enjoy reasonable success, particularly when certain of our products or features of a product have won industrial recognition as superior to the technology being offered by other prospective licensors.

Today we see our export markets in the developing countries, those that are building up their industrial infrastructure and as yet do not have the in-house and in-country capability to produce high-grade state-of-the-art systems. But unfortunately, our success in exporting to these countries has been dismal. Here are some examples and why we felt we were unsuccessful.

Two years ago, we bid a $10 million air pollution control project to a Taiwan power company. We spent some $50,000 on trip expenses to make technical presentations, develop subcontract bids from local fabricators, and establish a representative agreement with a Taiwan company for follow-up liaison and servicing.

There were nine bidders, from the United States, United Kingdom, France, Germany, Sweden and Japan. The customer required financing for the project. The best we could find in the United States was 13 percent from the Eximbank. The Japanese offered 9.5 percent in yen. The French came in with 7 percent. Consequently, the French company won the job. We attributed the lack of competitive financing as the reason we were ruled out of consideration.

More recently, 1 year ago we were part of a consortium of two U.S. companies and one Japanese company to provide an array of pollution control equipment for an oil refinery expansion in the People's Republic of China. Financing again was a main element and the client in this case was repaying his loans with barter, his refinery products.

The Japanese company, with its extensive international connections, was ready to take the barter for his portion of the contract. We in turn, because we did not have the resources to handle barter and did not have the time to explore this with others, had to walk away from the job. The Japanese company expanded its portion of the contract to supply from other Japanese sources the equipment that we were considering supplying.

In this instance a U.S. financing source with barter handling experience would have kept us in the picture. This project, as far as our out-of-pocket expenses, cost us about $25,000.

Several years ago, we were awarded a precipitator contract by a U.S. general contractor building a turnkey pulp and papermill in Nigeria. We knew that the Nigerians enjoyed $6 billion a year oil sales annually to the United States and that they had grand plans for industrial expansion.

Knowing this, several in my company went to Nigeria to determine market potential for our product and how best to be represented. We determined that there was potential enough to justify a sales representative.

However, as is the case in many developing countries, grease money is a way of life in order to move papers through the bureaucracy to get consideration for your products. Consequently,

suitable representatives requested commission rates higher than reasonable costs could justify. The U.S. paranoia at the time over such payments and the legal consequences against companies who knew their foreign representatives might be engaged in such activity caused us to withdraw entirely from Nigeria and other countries known to have such practices.

It is ironic that maybe as little as 10 years ago I could call the Department of Commerce in the District Columbia and ask them what the going commission rate in such countries was and be given a number. Today, Commerce hardly acknowledges the situation exists.

But our competitors—the French, the British, the Germans and the Italians—are not liable for what their representatives or subsidiary operations practice in countries such as Nigeria. We have as Americans $6 billion a year going into Nigeria, and when I was there for 2 weeks I saw Germans and French and Italians building all the roads, all the infrastructure, and everything else, capitalizing on the money that we had paid for the oil purchases. And here we, a U.S. company, were hurt because we could not play by the same rule book.

And then, as mentioned earlier, we are faced with the higher U.S. cost, the high U.S. dollar, expensive packaging and shipping costs for the heavy type of equipment that we market.

A small company such as ours is also faced with competing with the trading giants of the world, the Mitsui's of Japan, the Hyundai's of Korea and others, who within their corporate structure include international banking, manufacturing, financing, shipping, low-cost mobile construction laborers—in fact, everything to bid a turnkey project. And our company cannot compete against the likes of those, and it is obvious that many much larger U.S. companies also have the same problem.

To help correct the export imbalance, Congress passed the Export Trading Company Act. The concept has merit, but in my opinion it will never achieve the export goals of its planners until the banking, the finance industry, becomes an integral part.

This has to be coupled with other firms having extensive international marketing capability, shipping capability, and a construction firm having sources of cheap labor, and by definition I mean non-U.S. labor. The role I see the small U.S. manufacturer playing will not be one of a major exporter, but rather a subsupplier to the needs of such an ETC.

Only then, in my opinion, will a U.S. ETC be able to compete with the Mitsui's and the Hyundai's for the large multimillion dollar projects the United States needs to balance its trade. Unfortunately, in the meantime while we are building our ETC infrastructure, you can bet the Mitsui's and the Hyundai's will be sharpening their pencils to maintain position.

To sum up, my company sees our needs as follows:

One, competitive U.S. financing to meet what our international competitors can offer. On this point, our banking industry seems to have inexhaustible funds to loan to developing countries and are able to extend terms in a crisis. Indirectly, the depositors, you and I, taxpayers, are paying for this, and would it not be prudent to divert some of these funds to finance exports at competitive rates?

Two, the ability to accept and handle barter. Now, one might say that this problem is a problem for the exporter, and yes, but not entirely. Barter coming into the United States will generally be labor-intensive-type products and basic materials usually found in abundance in the United States. Barter therefore can and does create U.S. union objections which, unless properly considered and addressed, will discourage an exporter from accepting barter repayment.

And third, the right to engage representatives or businesses in a foreign country who in that country are allowed to operate under its customs without their, or the U.S. company, being encumbered by restrictive U.S. Government restraints.

In conclusion, Senator, the United States has a long, hard road ahead to enlarge its share of the evershrinking international marketplace, and as the developing countries increase their indigenous manufacturing capabilities they in turn become our new competitors for exports and the job gets tougher.

I think we can almost say that we are in a catch-22 position. The banks loan moneys to the developing countries and they are under an obligation to pay it back. They need the hard currency and they depend on the exports in order to get this, which defeats our goal to increase our exports.

As an example, in the paper last week Brazil announced that they were putting into operation one of the largest newsprint mills in the world, which would eliminate their need to import 85,000 tons of newsprint annually. So someone who was supplying them newsprint is going to suffer.

Another thing that Brazil is bringing on as a result of development money is their new frontier agricultural program. They are going to be producing soybeans and their intent is to go into the Asian marketplace to get share of market from U.S. suppliers.

Thank you.

[Mr. Stastny's prepared statement follows:]

STATEMENT BY

EUGENE P. STASTNY
DIRECTOR, TECHNOLOGY MANAGEMENT
ENVIRONMENTAL ELEMENTS CORPORATION
BALTIMORE, MARYLAND

My name is Gene Stastny. I am Director, Technology Management for Environmental Elements Corporation, a Baltimore company of 470 employees engaged in the designing, manufacturing, and constructing of systems for the cleaning and handling of industrial process gases, the treatment of water, the control of sound, and the disposal of industrial sludges and hazardous wastes. Our sales for these environmental protection systems range from 75 to 100 million dollars annually. Of this, some 2 to 5 million dollars represents export sales.

The majority of our export sales comes primarily from customers who know our products and specifically include them, or give preference to them, in their inquiries. In these instances, price, while important, is not the sole determinant.

As a general overall observation, U.S. industry has enjoyed a domestic market second to none in the world. This fact, more than anything else, has kept America from becoming a major international marketer. While in the past the U.S. enjoyed the largest dollar volume of exports compared to other industrial countries, these exports represented less than 10% of GNP as compared to 30% to 60% GNP of other industrialized countries Most foreign business enjoyed by American companies was because American-made products were wanted, not because we were out there hustling for sales. The vast majority of American industry has yet to learn how to compete effectively in export sales.

U.S. exports covering all types of pollution control equipment averaged about 600 million dollars annually from 1978 to 1982. The leading foreign markets having purchases over 25 million dollars were Canada, Saudi Arabia, Japan, Mexico, U.K., Korea, and France. Much of the sales to Japan, U.K. and Korea were for shipments to other countries. The leading competitors for world markets for pollution control equipment were Germany, U.K., Japan, Italy and Netherlands, most of whom increased their share of market in recent years.

When my company is offering what we will call mature products, and are competing toe-to-toe with international competitors of proven capabilities, we find ourselves non-competitive for a variety of reasons.

So that you better understand the nature of one of our products, we offer electrostatic precipitators for cleaning the exhaust gases from industrial smoke stacks. These precipitators are fabricated from carbon steel, they cost from 2 to 10 million dollars each, weigh 300 to 1,000 tons, and can be 50' high, 50' long, and 40 to 150' wide.

Most industrial developed countries have 5 to 6 suppliers of such devices, and making a sale into an industrialized country based on exporting from the U.S. is virtually impossible. Our exports are burdened with higher labor costs, high value of the U.S. dollar, packing and shipping charges, and customer favoritism for indigenous suppliers, all of which make exporting to these countries extremely difficult. Therefore, for the industrial countries of the world, my company seeks companies to license our know-how on a long term basis, and we settle for royalties and some sales of special components.

The majority of my time is devoted to establishing licensees worldwide. We enjoy reasonable success, particularly when certain of our products or features of a product have won industrial recognition as superior to technology being offered by other prospective licensors.

We see our export markets in the developing countries; those that are building up their industrial infrastructure and as yet do not have in-country capability to produce high grade, state of the art systems. Unfortunately, our success in exporting to these countries has been dismal.

Here are some examples and why we felt we were unsuccessful.

Two years ago, we bid some 10 million dollars of air pollution control equipment to a Taiwan power company. We spent $50,000 on trip expenses to make technical presentations, develop subcontract bids from steel fabricators, and establish a representative agreement with a Taiwan company for follow-up liaison and servicing. There were 9 bidders from U.S., U.K., France, Germany, Sweden, and Japan. The customer required financing. The best we could find in the U.S. was 13% from Exim Bank. The Japanese offered 9.5% in Yen. The French came in with 7%. The French company won the job. Lack of competitive U.S. financing ruled us out of consideration.

One year ago, we were part of a consortium of two U.S. companies and one Japanese company to provide various pollution control equipment for an oil refinery expansion in the Peoples Republic of China. Financing was a main element and the client was repaying the loans with barter - his refinery products. The Japanese company, with its extensive international connections, was ready to take the barter for his portion of the contract. We, in turn, because we didn't have the resources to handle barter and didn't have the time to explore this with others, had to walk away from the job. The Japanese company expanded its portion of the contract to supply the equipment from Japanese sources. In this instance, a U.S. financing source with barter handling experience would have kept us in the picture. Our out-of-pocket expenses for this project were about $25,000.

Several years ago, we were awarded a precipitator contract by a U.S. general contractor building a turnkey pulp and paper mill for installation in Nigeria. Knowing that Nigeria enjoyed 6 billion dollars in oil sales annually to the U.S. and had grand plans for industrial expansion, several from my company went to Nigeria to determine market potential for our products and how best to be represented. We determined potential enough to justify establishing a sales representative agreement with a local company. However, as is the case in many developing countries, grease money is a way of life in order to move papers through the bureaucracy to get consideration for your products. Consequently, suitable representatives requested commission rates higher than reasonable costs could justify. The U.S. paranoia at the time over such payments, and the legal consequences against companies who knew their foreign representatives might be engaged in such activity, caused us to withdraw entirely from Nigeria and other countries known to have such practices. It is ironic that maybe as little as 10 years ago I could call the Department of Commerce in D.C. and ask what the going commission rate was in such countries and be given a number. Today, Commerce hardly acknowledges the situation exists. Our foreign competitors; French, British, and

Italian, aren't liable for what their representatives or subsidiary operations practice in countries such as Nigeria. Here we, a U.S. company, hurt because we don't play by the same rule book.

As mentioned earlier, we are also faced with higher U.S. costs, the high U.S. dollar, and expensive packaging and shipping costs. A small company such as ours is also faced with competing with the trading giants of the world, the Mitsui's of Japan, the Hyundai's of Korea, and others who, within their corporate structure, include international marketing, manufacturing, financing, shipping, low cost mobile construction laborers - in fact, everything to bid a turnkey project. Our company can't compete against the likes of those, and it is obvious that many much larger U.S. companies also have the same problem.

To help correct the export imbalance, Congress passed the Export Trade Company Act. The concept has merit, but in my opinion it will never achieve the export goals of its planners until the banking (financing) industry becomes an integral part. This has to be coupled with other firms having extensive international marketing capability, shipping capability, and a construction firm having sources of cheap labor; by definition, non-U.S. labor. The role the small U.S. manufacturer will play will not be one of a major exporter, but rather a sub-supplier to the needs of such an ETC. Only then, in my opinion, will a U.S. ETC be able to complete with the Mitsui's and Hyundai's for the large multi-million dollar projects the U.S. needs to balance its trade. And in the meantime, while we are building our ETC infrastructure, you can bet the Mitsui's and Hyundai's will be sharpening their pencils to maintain position.

To sum up, my company sees our needs as follows:

1. Competitive U.S. financing to meet what our international competitors can offer. On this point, our banking industry seems to have inexhaustible funds to loan to the developing countries and are able to extend terms in a crisis. Indirectly, the depositors (taxpayers) are paying for this. Would it not be prudent to divert some of these funds to finance exports at favorable rates.

2. The ability to accept and handle barter. One might say this is the problem of the exporter. Yes, but not entirely. Barter coming into the U.S. will generally be labor intensive type products and basic materials usually found in abundance in the U.S. Barter, therefore, can and does create U.S. union objections which, unless properly considered and addressed, will discourage an exporter from accepting barter repayment.

3. The right to engage representatives or businesses in a foreign country who, in that country, are allowed to operate under its customs without their, or the U.S. company, being encumbered by restrictive U.S. Government restraints.

In conclusion Gentlemen, the U.S. has a long, hard road ahead to enlarge its share of the ever shrinking international marketplace, and as the developing countries increase their indigenous manufacturing capabilities, they in turn become our new competitors for exports, and the job gets tougher.

Thank you,

Senator MATHIAS. Thank you both very much. You have justified my hopes that this record would be made more realistic and more useful by reflecting some of the real life conditions in the marketplace with which you deal every day.

Mr. Stastny, you gladdened my heart by your view that we will never achieve our export goals until the banking industry becomes an integral part of the process. I have made myself extremely unpopular with those who are trying to merge the Commerce Department and the Special Trade Representative's Office, by insisting that if that merger is to be worth anything it has to have some interface with the financing side, because until money is a part of trade policy it is not going to be worth anything.

Let me go back and ask you this question. You look across the table and you see foreign competitors and you have to deal with their presence in the marketplace. Do you think that the people against whom you compete get more help from their governments than you get from the U.S. Government?

Mr. RENNEBURG. Definitely, I think so.

Mr. STASTNY. I agree.

Senator MATHIAS. Both of you mentioned financing. Is that the principal point?

Mr. RENNEBURG. Yes, I think that is the principal point, one of the major things.

I do not believe I mentioned in my remarks, but in talking with a gentleman who was in here the day before yesterday from Hamburg, Germany, he said that the Government was giving Siemens, I believe it was, the huge electrical combine, substantial amounts of money for research, which in turn—this is rather curious—they were sending it over here and investing it, because they could get a greater return. And it was making the German Government very annoyed about it.

Mr. STASTNY. That is right. I had a visitor from the city of Hamburg the other day who said that their businesses, their steel businesses, have taken their capital assets and moved into the market here in the United States, rather than investing in their own industry. And he was there trying to encourage our company to invest in his city to produce our products.

Mr. RENNEBURG. It would be very nice to have the Government get you some money that you could just put into CD's or something like that. [Laughter.]

Mr. STASTNY. Senator, a lot of our customers are not the government bodies that the big dollars go to. A lot of them are smaller companies that do not want to go to their government, to get encumbered by all kinds of bureaucratic financing, so that money is generally not available to them.

AID helps, sometimes it is the way to go. But certainly a source of financing is necessary in order to compete with other international companies that are marketing in the world.

Mr. RENNEBURG. And usually long-term financing.

Senator MATHIAS. How would you structure it? Would you enlarge the services of the Eximbank or would you see the need for some different kind of institution?

Mr. STASTNY. I guess I have a problem with the Eximbank. I have gone to the Eximbank and brought these things to them, and

Eximbank or the international banking policy says if any country is violating the rates that they—Exim—will go back and meet it. But it never happens, at least not in my opinion. I have never seen it and it does not happen fast enough.

You know, we only have maybe 3 months or so to prepare a quotation. By the time we go through all the paperwork and everything, it—the contact—is gone. And our competitors apparently have a system that has told them that: Here is what you can use; go out there and bid on that basis. We are playing catchup trying to find competitive financing and it is too late, too slow.

Mr. RENNEBURG. I concur in that.

Senator MATHIAS. What about the effect of the Eximbank restrictions in countries that are prosperous countries, such as New Zealand for example?

Mr. RENNEBURG. We have not done anything in New Zealand recently or in Australia in recent years.

Mr. STASTNY. Well, New Zealand is not a market for us. It is too small for our products.

Senator MATHIAS. Maybe that is a poor example. But of course, the New Zealand economy by world standards is relatively prosperous, and that limits the kind of help that you can get in making a sale in New Zealand.

Mr. RENNEBURG. We had a problem because they were tied in some years ago with the sterling block, Australia particularly.

Senator MATHIAS. That may be a matter of interest, but it does not help you sell your goods there.

Mr. RENNEBURG. Exactly.

Senator MATHIAS. Which is the bottom line.

Mr. RENNEBURG. Precisely.

Senator MATHIAS. What is your observation as to the impact of exchange rates on your ability to make sales?

Mr. RENNEBURG. Well, I think as the dollar has firmed we have found that people just cannot afford it. Even our business with Canada has dropped off because there is, what, 15- or 20-percent differential between the Canadian dollar and the U.S. dollar. It places quite a burden on them, even in those industries or in those applications where you do not have tariffs to contend with. So I think that is a very serious thing.

We used to do a great deal of work in Iceland. In fact, our chief engineer, Dr. Haldorfsen, was from Iceland. It became very difficult because the Icelandic krona was way down and the currency differential was such that we could not compete.

And then of course the Norwegians moved in and they were able to barter. They would sell fishmeal machinery and take back fishmeal, for example. And of course, we were not interested in fishmeal and we did not want to hurt our customers in this country which are producing it. So bartering was not a solution from our standpoint.

Mr. STASTNY. I am sure the exchange rate hurts us. The way we feel it is with our licensees. In our licensing agreements, we require certain annual minimum royalty payments, and that is escalated after a certain number of years to reflect the changes in costs of steel and labor.

When the exchange rate gets way out of whack, they suddenly find that this minimum far exceeds the number of U.S. dollars they have to pay us as compared to the royalties they get on their sales. So they are taking their money to buy U.S. dollars to pay us under this contract arrangement, so there is an imbalance there. It creates a problem for them and then we have to go back and redress this problem.

Senator MATHIAS. You mean you end up renegotiating, in effect?

Mr. STASTNY. That is usually the case, yes. If we have a good partner we will bend over backwards to find some way to maintain the business with them.

Mr. RENNEBURG. Another problem we have is the matter of ocean freights. I recall not many years ago when we sold one of these fertilizer plants to India, the plant itself was about $1.2 million as I recall and the ocean freight was $450,000 on top of it.

We had to ship by American bottoms at that time, and we like to do it and have almost invariably done it. But in other applications in other countries where their own flag vessels were involved, it cuts the ocean freight way, way down because they are paying their seamen such very low rates.

But if you are dealing with Eximbank, if I recall correctly, you should ship it, of course, in American bottoms. And with the World Bank, and we are often in competition with the Italians and the Germans and the French and other signatories or other participants in the World Bank, and then I believe the part that we could furnish is the amount, the percentage that the American dollars have been involved in the World Bank itself.

But due to high ocean freight rates—as you have mentioned, we have had to do a lot of licensing abroad also. We have had equipment made in France, we have had it made in Iceland, we have had it made in Peru and in Chile and in other areas. But we prefer to do it here if we possibly can.

But I do not know what we can do as far as reducing it. Now, we are subsidizing, I am sure the Government is subsidizing the American merchant marine, which of course has been in a sad state of decline. I do not know what we can do to overcome that. We would like to ship more on American vessels, but the costs just throw us even further out of competition.

Senator MATHIAS. You both mentioned the difficulty of bartering. On Monday afternoon the witnesses will include Sears World Trade, the American Export Group, and some others who as a matter of fact are currently organizing to help American exporters handle barter trade.

It is interesting that this is a private initiative, this is not a Government initiative. But it could be a useful answer to some of the problems that you have just enunciated.

Mr. RENNEBURG. Yes.

Senator MATHIAS. Given the whole array of problems that you have to confront as exporters—interest rates, exchange rates, financing difficulties—what is the most difficult impediment? What would you rate as your No. 1 problem as an exporter?

Mr. RENNEBURG. Making the sale, of course, which ties into all of these things.

Senator MATHIAS. Getting into the customer's mind?

Mr. RENNEBURG. That is right. It is a little frightening at times. I remember the first time I went to India they took my passport away. It was about the time Nixon had recognized Pakistan and the Indians were pretty mad at us, and it made it very, very difficult to do business. But we finally got the contract.

I think it is largely financing that is the major problem. I think our prices very often are competitive and in some instances under, because we know less expensive ways of doing things.

Some years ago we were down in Peru and Chile and our Norwegian competitors were selling a fishmeal plant for a $1 million or $1½ million and we were going with $350,000 to $500,000, and we could produce just as much fishmeal in it. So they bought more of those than they bought foreign ones.

I think American technology has to keep ahead, and that is what we are trying to do. But it is like batting your head against the wall without financial help, especially for smaller businesses.

Mr. STASTNY. Yes. We pride ourselves on the quality and sophistication of our products and try to stay at the leading edge of the state of the art, which wins us approval by our potential customers. But when it comes to the hard dollars and the financing that goes along with it, that rules it out. They will take second best and not spend as much in the financing end of it.

Senator MATHIAS. I would call your attention to the efforts that in particular Senator Garn of Utah, the chairman of the Banking Committee, has made in order to try to strengthen Exim. I will see that he has an opportunity to review your testimony, because I think it supports the position that he has taken that something has to be done on the financing side. That has been my own experience.

Some years ago I was trying to help a Maryland company with some sales in South America, some aviation equipment. The customer had picked the Maryland product as the preferred choice, but ended up buying the European product because of the long-term, lower cost financing that was available in Europe. It was the financing that ultimately influenced the customer's choice. That really is what you are telling us here today.

Mr. STASTNY. There are some fantastic arrangements in financing. Sometimes they have a 3- or 4-year moratorium with no payments and nothing down, and then start in the fifth year, and then in the fifth year, over the next 20 years, 8-percent or something.

Now, the seller of that equipment I am sure is not accommodating those terms. He cannot possibly accommodate them. I know we could not.

Senator MATHIAS. You make it sound like the old farm auctioneer who says, take the cow and take her home, put her on grass and let her make money. [Laughter.]

Do you have any experience with the GATT process? Have either of you been enmeshed in that web?

Mr. STASTNY. Not really.

Mr. RENNEBURG. No.

Senator MATHIAS. I was going to ask you if you had any suggestions for change there, but since you have not been involved in it I will not go into that subject.

Again as a preview of coming attractions, let me say that on Tuesday Exim will be with us and will testify with respect to their

new efforts to try to be more helpful to smaller businesses, not just to the Boeing's and the IBM's. Under the bill that the Congress has been working on, there would be a set-aside of Exim assets of at least 10 percent for smaller businesses, so that the giants would not gobble it all up.

Mr. RENNEBURG. Good.

Senator MATHIAS. That may be of some small help.

Well, gentlemen, if you have nothing further, we are very grateful to you for being here. I think your personal experience is an essential part of this record and will make it more valuable. We thank you both very much.

Mr. RENNEBURG. Thank you, Mr. Chairman.

Mr. STASTNY. Thank you, sir.

Senator MATHIAS. Our export services seminar will begin at 9 o'clock Monday morning with a presentation on export trading companies. The leadoff will be the Commerce Department and Arthur Young & Co.

So we stand adjourned.

[Whereupon, at 2:45 p.m., the subcommittee adjourned, subject to call of the Chair.]

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APPENDIX

SUPPLEMENTAL MATERIAL

The material in this section is submitted to supplement the record of the June 15, 1984 trade policy hearing proper with statements from the 2-day export services seminar which followed on June 18 and 19. The schedule of speakers begins this section, and is followed by the prepared statements of 13 of the speakers who made their remarks from written texts.

These statements have general applicability to U.S. firms having an interest in getting into or expanding their export activity. They complement the statements of hearing witnesses, by going beyond consideration of the policy environment, to look at specific steps U.S. firms can take to expand our country's exports.

SEMINAR ON EXPORT SERVICES, JUNE 18-19, 1984,

POLICE ADMINISTRATION BUILDING AUDITORIUM, BALTIMORE, MD

Monday, June 18, 1984

EXPORT TRADING COMPANIES

9:00 a.m.—Welcoming Remarks: William Boucher III, Chairman, The Export Club; John F. Smith, Secretary, The Washington/Baltimore Regional Association.[1]

9:30 a.m.—Tax Considerations in Exporting: DISC and FSC: Kevin Dolan, Arthur Young International Services Organization; Negotiating Shipping Terms: James Calderwood, Grove, Jaskiewicz, Giliam & Colbert; Export Licensing: J. Phillip Jordan, Partner, Venable, Baetjer, Howard and Civiletti.

11:00 a.m.—Export Trading Companies: Formation and Uses: Vincent Burke, Assistant Director, Office of Export Trading Co. Affairs; Ted Gebhard, Senior Antitrust Economist, OETCA, U.S. Department of Commerce.

12:00 p.m.—Luncheon, Police Administration Building: Speaker, Harry L. Freeman, Senior Vice President, Corporate Affairs & Communications, American Express Company.

PRIVATE SECTOR SERVICES FOR EXPORT PROMOTION

2:15 p.m.—Trading Company Support: Coordinator: Winstead—Myron M. Miller, Vice President, North American Business Development, Sears World Trade Co.; Richard Jamison, Senior Vice President, Atlantic Trading Corporation.

3:30 p.m.—Banking and Insurance Services: Coordinator: Winstead—Introduction: Jack Smith, Secretary, Washington/Baltimore Regional Association: Service Export Opportunities; Rafael Diaz-Balart, Vice President International, National Bank of Washington; W. Griffen Morrell, Jr., Maryland National Bank; Joseph Tamulis, Alexander & Alexander Insurance; Pierre Debbaudt, Philadelphia National Corporation.

6:00 p.m. Reception by Arthur Young & Co., and Venable, Baetjer, Howard and Civiletti.

[1] Represents the Economic Development Council of Greater Baltimore and the Greater Washington Board of Trade.

Tuesday, June 19, 1984

STATE AND LOCAL SUPPORT FOR EXPORTING

Host: William Boucher III, the Export Club

Morning Chairman: Frank DeFrancis, Secretary, Department of Economic and Community Development, Maryland

9:00 a.m.—Introduction: William Boucher III, The Export Club; Welcoming Remarks: Governor Harry Hughes, State of Maryland.
9:30 a.m.—Maryland State Development: Department of Trade Expansion Programs—Frank DeFrancis, Secretary, Maryland Department of Economic and Community Development.
10:15 a.m.—Maryland Port Facility Plans and Export Programs—Greg Halpin, Director, Maryland Port Administration.
11:00 a.m.—BWI Airport and Free Trade Zone—James Truby, Director of Aviation, State of Maryland; Holabird Free Trade Zone—Bernard Berkowitz, Baltimore Economic Development Corp.
11:30 a.m.—Other Port Authorities—Dr. Raymond G. Heinzelmann, Director, Delaware Port Authority; Michael Meyer, Assistant Director, Xport, Port Authority Trading Co., New York/New Jersey.
12:15 p.m.—Luncheon: Police Administration Building—Speaker: U.S. Secretary of Commerce Malcolm Baldrige.
1:45 p.m.—Presidential "E" Award to K & L Microwave Co.

FEDERAL GOVERNMENT ASSISTANCE PROGRAMS

Chairman: William Boucher III, The Export Club

2:00 p.m.—U.S. Commerce and Foreign Service Support Programs—James Hilbert, Assistant Director, Commerce District Office.
2:45 p.m.—Exim Services for Exporters, Small to Large—Garrett Boyd, Special Assistant to Chairman, U.S. Eximbank.
3:45 p.m.—U.S. Small Business Administration—Justin Palmisano, Export Loan Officer.
4:15 p.m.—PIC Insurance and Finance Services—L. Ebersole Gaines, Executive Vice President, Overseas Private Investment Corporation.
5:00 p.m.—Financing Feasibility Studies for Exporting—Christian Holmes, Director, Trade and Development Program.

EXPORT COOPERATION: THE LEGAL FRAMEWORK

(Remarks of James S. Calderwood[1] before the Seminar on Export Services, Washington/Baltimore Regional Association, Baltimore, MD, June 18, 1984)

I. INTRODUCTION

On a trip to Sweden last year I was engaged in a conversation with some business managers concerning the purchase of American machinery in that country. One of the gentlemen pointed out his office window and drew my attention to a specialized piece of transportation equipment that was being used at his plant. He told me the equipment was made in Germany and that practically all the Swedish companies in that industry are now using the German made machine. He added that up until about 5 years ago that type of machinery was purchased almost exclusively from American companies. When I asked why they had switched to the German made machine he replied that the German manufacturer was more aggressive in its marketing activities and seemed to care more about the Swedish market than had the American companies. He said that it was true that the German company's price was cheaper, but he emphasized that that was perhaps a minor part of the reason

[1] Mr. Calderwood is a partner with the Washington, D.C. based law firm of Grove, Jaskiewicz, Gilliam & Cobert. He has worked on many matters in the field of trade restraints including international shipping and the law of the European Economic Community. He has assisted in implementing several cooperative arrangements among companies for export trade. He was formerly a senior trial attorney with the Antitrust Division of the Department of Justice, is an honors graduate of the Law School at George Washington University, and has done graduate work on international competition problems at Oxford University. He serves as chairman of the editorial board of the monthly publication Transportation/Antitrust Report.

that the Swedish companies had switched from an American made to a German made device. He felt the Germans were simply more interested in their export markets and were consequently a more reliable supplier than American companies.

It is instances like my experience with the Swedish businessman that makes it so important for American managers to be attending seminars such as this one. With a trade deficit of $25.8 billion for the first quarter of 1984, a record coming on top of a trade deficit of $19.4 billion for the last quarter of 1983, we in America have a distinct problem with our export trade.

A good deal of the problem with American companies exporting abroad is attributable to the high value of the U.S. dollar in international markets. This of course causes the price of American exported goods to be unrealistically high. In addition, as was reviewed on Friday at the U.S. Senate Foreign Relations Committee hearings here in Baltimore, the severe debt problems of certain Latin American countries and less developed countries has meant that those nations have had to significantly reduce the amount of money they can spend on importing products from the United States and elsewhere. These two problems, the high international price of the U.S. dollar and the significant debt problems that many of our traditional trading partners are having, combine to seriously impede U.S. export trade.

Nevertheless, there are foreign markets available for literally thousands of products that are manufactured in America. Many of these tend to be rather specialized types of items made by small and midsize companies that have traditionally only marketed in the United States.

Such companies have failed to seriously explore for markets overseas. This is because often the management of those companies has simply not been export minded. These managers have tended to look upon export markets as something that only large corporations can deal with and have become confused when they have to be concerned with a multiplicity of import rules for other countries, transportation requirements, marketing devices, and foreign laws. This makes the small company manager hesitant to go forward into foreign markets. Typically, the small and midsize American manufacturing company is run by a very small management group which, if they have no export trade background among them, simply ignore the foreign market.

I believe that I am now beginning to see a greater awareness among these smaller American companies of the potential for export trade. It seems that more and more American companies are taking an interest in foreign sales and at least investigating the various alternatives that may be available to them to develop foreign markets. Today, I would like to touch upon certain legal problems that have sometimes been raised as barriers to American companies being able to engage in export sales. Specifically, I would like to talk about some recent legal developments which actually encourage American companies to participate cooperatively in export trade.

II. SHIPPING ACT OF 1984

Today, June 18, the Shipping Act of 1984 becomes effective. This is a statute signed by President Reagan on March 20, 1984, that extensively revises the regulation of the maritime industry serving the United States. I will not bore you with all the details of this rather lengthy statute but suffice it to say that it provides for greater areas of cooperation among shippers and among water carrier operators (e.g. steamship companies) to work together to facilitiate the transportation aspects of exporting products from the United States. Basically, the way the system operates is that carriers file with the Federal Maritime Commission (FMC) their tariffs and contract arrangements with shippers. The FMC being the principal regulatory agency in international transportation.

Historically, it was difficult for smaller shippers to be able to obtain the volume rates from water carriers available to those large volume shippers who shipped in great quantities. In part this was because in international maritime trade entities known as "shippers' associations" could not operate as they do in domestic transportation. Shippers' associations have been emerging as an important concept in domestic transportation (movements by motor carrier or rail carrier within the United States). Shippers' associations are recognized entities under the Interstate Commerce Act when they operate in domestic surface transportation. A shippers' association is a voluntary cooperative organization made up of companies that wish to take advantage of volume rates offered by carriers, but individually may not be able to generate the volume necessary for the lower rates. The shippers' association will arrange for aggregating the shipments of many such companies and enable them to take advantage of volume rates such as for trailer or container load shipments. A shippers' association will physically consolidate loads, perform pickup and delivery

services, arrange for insurance and accomplish most of the "paperwork" aspects of a movement. There are a couple hundred such organizations in the United States today and they have become a significant force in the transportation industry, particularly because of the transportation savings they make available to shippers of small lots.

The new Shipping Act specifically recognizes shippers' associations for international trade. As a result, many shippers' associations are now in the process of becoming active in international movements. Such organizations can handle a great deal of the export paperwork which often accompanies export sales by U.S. companies and can arrange for transportation services for the exporting of goods at rates significantly lower than what may be available to small lot shippers on an individual basis.

I would suggest to anyone who is interested in developing export markets that they seriously consider joining a shippers' association because such an organization can provide the professional transportation expertise and the ability to obtain reduced shipping rates that can lessen the delivered cost of goods in addition to saving management time and aggravation on the "paperwork" problems of transportation to foreign countries. More information on such associations and a list of those in your area can be obtained from the American Institute for Shippers' Associations, 1411 K Street, N.W., Suite 700, Washington, D.C. 20005, telephone (202) 628-0935.

III. EXPORT TRADING COMPANIES

It seems that whenever companies start to consider the possibility of cooperating for the development of export trading markets someone at some point raises a question about whether or not such activity would violate the antitrust laws. This is particularly true if the companies considering the joint venture are competitors or potential competitors with one another in the domestic American market. There seems to be a great deal of confusion among companies on this issue and even among some lawyers. I think those antitrust specialists who have worked in this area realize that it is not as significant a barrier to export trade as some believe. The Antitrust Division of the Department of Justice has made many public statements over the last few years that they feel that cooperative efforts by domestic competitors to develop export markets would rarely, except in limited circumstances, be a violation of the antitrust laws. In an effort to help alleviate some of this antitrust confusion Congress, in 1982, enacted the Export Trading Company Act. Title III of this Act provides a means by which companies desiring to cooperate with one another for export trade can receive a Certificate of Review from the Department of Commerce which, if issued, practically eliminates the possibility of antitrust action being instituted against those companies for activities covered by the Certificate of Review. Under Title III, companies desiring to form a cooperative export trade marketing system can apply to the Secretary of Commerce for a review of the activity. The Department of Commerce, with the concurrence of the Department of Justice, reviews such applications under criteria spelled out in the Export Trading Company Act and, if it is determined that no significant antitrust issues are raised, issues the Certificate of Review. So far about 35 applications for Certificates of Review have been submitted to the Department of Commerce and 23 certificates have been issued. Several are pending review. No applications have been denied although some have been modified after conferences between the staffs of the Department of Commerce and Department of Justice and the effected companies.

There is no doubt that there is a strong feeling by government officials that these certificates should be issued. I caution that it is plain under the Act that even with a Certificate of Review, cooperating companies will not be able to use the export trading company mechanism as a device to "enhance, stabilize, or depress prices within the United States." In other words, the activity of the export association is to be just that—for export—and can not involve prices or markets within the United States.

Under Title III of the Export Trading Company Act a means is now provided by which American exporters working in cooperation from one another can be assured that their exposure to antitrust challenge, by either private suits or government action, is severely limited.

I note that the Export Trading Company Act provides for the Certificates of Review which then can serve as assurance to those participating companies that there is little likelihood that they would be involved in difficulties under the antitrust laws for cooperative export efforts. However, the statute is not an exemption from the antitrust laws. For those companies who fear that cooperation for export

trade with another would violate the antitrust laws and therefore be unable to obtain a Certificate of Review under the Exporting Trading Company Act there is another statute, the Webb-Pomerene Act, which grants a statutory exemption from the antitrust laws for export trading companies. To obtain this antitrust immunity, Webb-Pomerene associations must register with the Federal Trade Commission (FTC) and file periodic reports with that Commission. The FTC does not grant approval for such organizations, such an organization merely registers with the FTC and complies with FTC reporting requirements.

In addition to the Export Trading Company Act, and the Webb-Pomerene Act the Department of Justice also provides a business review procedure whereby proposed actions can be submitted to the Antitrust Division for determination of whether or not that Division will proceed against the proposed action. This procedure is also available to companies whose activities may involve export trade to determine whether or not they would have antitrust difficulties.

In summary, I think it can be said that fear of the antitrust laws by companies cooperating in the export trade is greatly exaggerated. The government has provided means by which companies so participating can determine ahead of time whether or not they will have any antitrust difficulties. Companies can receive Certificates of Review which have the practical purpose of preventing the filing of any antitrust suits attacking the arrangement. In addition, under the Webb-Pomerene Act, even activities which would be avowedly a violation of the antitrust laws can be undertaken with an exemption from those statutes.

IV. CONCLUSION

We now have in the American business community with respect to export trade several means by which companies are actually encouraged to participate jointly in export efforts. Through the new Shipping Act, the Export Trade Act, and the Webb-Pomerene Act small and midsize companies, in addition to large ones, that wish to cooperatively engage in activities which will boost their export activities can do so. Many companies that previously did not engage in selling their products in overseas markets have undertaken joint ventures with other companies in the same product line to target specific foreign countries which promise to be potential markets. Cooperative export actions do not have to be aimed at all world markets at the same time. Instead, through various export service organizations, specific countries can be targeted where there seems to be a good likelihood of a desire for the products of the American companies. These particularized markets can then be developed and expanded upon into other loactions. In such a way small and midsized manufacturers can develop export markets. The legal barriers to such developments that previously existed or which were thought to exist are no longer as onerous as some have believed and there is a clear policy of the government to encourage such activity. With a little guidance it is possible for American corporations which now have very little export sales to greatly expand this area of their marketing activity.

Outlook for World Trade

(By Harry L. Freeman, Senior Vice President, Corporate Affairs & Communications, American Express Company, Before the Seminar on Export Services, Baltimore, MD, June 18, 1984)

Thank you.

Considering the time of year, I think it's appropriate if I adopt the tone of a graduation speaker.

I won't be able to offer you any diplomas, but—as is usual with commencements—I will share some thoughts about the wide-ranging opportunities and challenges that face you in today's world.

In addressing graduates, it's traditional to begin by saying, "You are the future of this nation." And that's an apt way for me to start also. You—as exporters—are very much the future of this nation.

Viewing exports' past role in the U.S. economy, it would have seemed very odd to make such a statement just a few years ago.

After all, despite all the legends of the "Yankee traders," the United States pursued economic self-sufficiency for most of its history.

But that situation has changed since World War II—slowly at first and dramatically in recent years.

Today I'd like to:

Give you the big picture of America's overall stake in global trade and talk about some of the forces that have crippled overall world trade.

Second, I'd like to zero in on a rapidly growing but little heard of area: service sector trade. Services trade is of obvious significance to my company, American Express, but it's also of vital importance to you, whatever your own exports might be—manufactures, commodities or services.

Finally, I'll suggest some ways to reduce barriers to international trade.

First, the big picture. A quick glance at the numbers shows how the importance of trade to U.S. economic health has sharply increased in our time.

In 1970, trade contributed $83 billion to the U.S. GNP.

By 1980, that figure had soared to $462 billion.

Today, over 20 percent of U.S. industrial production is exported, involving one of every six U.S. workers; also, 40 percent of U.S. agricultural produce is exported.

One dimension of this phenomenon is the growing economic interdependence of the United States and developing countries. For example, we import 100 percent of our tin, 90 percent of our bauxite and 70 percent of all our natural rubber from developing countries. But many of these same developing countries are our best customers in return. Almost 40 percent of U.S. manufactured exports are sold to developing nations; and over one-third of all U.S. exports are shipped to developing nations.

Clearly, neither the United States nor the world at large could afford, or indeed survive, the loss of a viable, open trading system. Yet that is just what is happening.

Our world trading system is facing its most serious challenge since the 1930's. We cannot be sure there is sufficient political will, in any of our various nations, to keep it alive. Since 1979, world trade has stagnated. In 1981 and 1982, it actually declined. In 1983, even though a recovery was under way, international trade sagged far below the levels of the 1970's.

In 1983, the U.S. trade deficit was a record $69 billion. Recent projections have claimed that it will rise to $100 billion in 1984 but I will bet the deficits will hit between $130 and $170 billion—if we're lucky.

What is the reason for this dismal picture? Some of the decline in trade is caused by recession and the slowdown in economic activity. It is also caused by a dangerous increase in protectionism. The main culprit behind protectionism is recession.

Despite varied levels of recovery, lingering recession still afflicts much of the industrialized world. At its worst, the recession drastically reduced international trade, and at the same time the decline of trade lengthened and deepened the recession internationally.

In the United States, a dramatic drop in exports clearly intensified the worst of our recent economic distress. From March 1981 to September 1982, U.S. exports declined by $22.5 billion—a figure that accounts for three-quarters of the decline in real net GNP during the same period. In human terms, that meant a loss of 1.5 million jobs.

Now, when demand falls and unemployment grows during a recession, governments—wherever they may be—typically respond by blocking imports and attempting to increase exports. Protectionism is a form of economic heroin: an injection brings a sense of temporary well-being. But in the end, it destroys the whole system.

Mercantilist policies these days have taken new and ingenious forms . . . because no one wishes to appear protectionist. Frequently, protectionism is real "back room" stuff, but occasionally it's straight out—like quotas on textiles and cars.

As a result, governments have acquired a seemingly endless array of camouflaged protectionist measures and devices that lie outside the international rules which govern trade. An estimated one half of international trade is subject to these barriers. So-called "voluntary" export restraints, such as those imposed by the United States on Japanese auto exporters are one example. Similar agreements have been applied to trade in steel and home electronic equipment. Not so long ago, EEC and Japanese Government officials arrived at a "voluntary export agreement" affecting the export of Japanese video cassette recorders to Europe.

Another example of the new mercantilism is "countertrade," which is essentially barter of goods for other goods—where there is no market competition affecting the price of the goods traded. It is estimated that 30 percent of international trade is now countertrade—up from only 2 percent 10 years ago. Like voluntary export restraints, countertrade lies almost entirely outside the agreements that regulate world trade.

Then there is "industrial policy" which often appears in the news these days. Essentially, "industrial policy" initiatives mean industrial subsidy—which, in some situations, is a sensible thing if used to help technologically advanced industries that are still in their infancy. Too often, however, such subsidies are used to shelter obso-

lete industries—protecting them from economic reality in general and foreign competition in particular. In this context, "industrial policy" is a nice way of saying "protectionism."

All told, about half of all world trade is subject to some form or restraint, and this trend is accelerating. And this is bad.

Besides protectionism, another serious burden that weighs on international trade today is fiscal imbalances. By that, I mean not only the Third World debt problem but also the runaway budget deficits that the United States is producing on a regular basis. Many people perhaps wouldn't like to talk about Brazil and the United States as both being debtor nations, but it is true.

We are hearing a lot these days about the debt problem and its impact on banks. But, the debt problem is also a global trade problem because it means developing countries cut back on imports—which, of course, are your exports—so that they can get their economies in order and repay their debts.

The International Monetary Fund warned recently that even if recovery continues, debt payments will soak up 25 percent of Third World export earnings by 1987.

In some countries, interest payments alone already consume 50 percent of their export earnings. Such massive burdens render these countries virtually incapable of trading internationally or or growing economically. Their futures are mortgaged. You and I both lose customers we need and want. From 1981 to 1983, U.S. exports declined 14 percent overall, but our exports to Latin America plummeted a whopping 42 percent.

Another fiscal imbalance burdening trade is soaring government deficits—especially in the United States. Our U.S. budget deficits—$195 billion last year alone—are far too high. So are our interest rates. The U.S. Government debt burden is absorbing a tremendous flood not only of American capital but also capital from around the world.

As the private sector also seeks funds, as it is now doing, there is upward pressure on U.S. interest rates. We certainly have seen vivid evidence in recent weeks of just how fast interest rates can rise. This increase in interest rates, in turn, is driving up the value of the dollar even further. It is now at a record high against several major currencies.

The American deficits also create problems in the trade area. Our high interest rates force less-developed countries to cut back on their imports—your exports. The strong dollar also makes your goods more expensive in world markets and thus contrutes to a U.S. trade imbalance and protectionist pressures at home. In short, our deficits help spread the dangerous contagion of contracting trade and protectionism.

To recap: protectionism, Third World debt and fiscal deficits are all posing a critical threat to world trade, and to your individual businesses.

One bright spot in this dismal picture has been the service sector, and that is my second major topic.

What do I mean by the "service sector"? Most people define "services" as what they are not. They are everything that is *not* manufacturing, mining or agriculture. But that is a negative definition.

One very limited way to think of services is as a facilitating agent, the grease . . . so to speak . . . that allows manufacturing, agriculture and trade to happen.

Without banking . . . or construction . . . or insurance . . . or transportation—all of which are services—there is not a single factory that would be able to operate.

Nor would there be any foreign trade. The trading of goods among nations depends upon the services that support those goods. I am talking here of things like training and maintenance, not to mention the financing of trade.

But services are more than just an adjunct to goods. They represent a body of trade in and of themselves.

A major study by the U.S. Trade Representative's office identifies the following as part of the service sector:

Banking; insurance; transportation, which includes both aviation and maritime services; non-bank financial services, like companies that have securities brokerage, charge cards and travelers cheques, asset management and insurance (to give a brief description of American Express); telecommunications; data processing; professional services—lawyers, architects, management consultants, doctors; advertising; motion pictures; and travel and tourism services.

American Express, or course, is a major player in the service sector and in the trade of services.

Our bank—American Express International Banking Corporation—can be a valuable asset to any American company that wishes to export its goods, commodities or services.

The Bank, which has 88 offices in 39 countries, is one of the oldest and most experienced U.S. banks specializing in international business.

The Banks international network can:

Verify credit ratings; arrange export financing; collect documentation; and trade in the foreign exchange markets . . . .

All of these services help you—the exporter—concentrate on what you do best—selling your products, not worrying about financial and bureaucratic details.

Likewise, our Travel Related Services Company can be of major assistance in helping American exporters trying to do business overseas.

We can replace lost or stolen Travelers Cheques throughout the world; we can arrange trips through our Travel operations; our cards, particularly the Corporate Card, can be invaluable in managing the finances of sending executives abroad.

If you've used our Card or Travelers Cheques to entertain clients overseas, I think you understand the value of American Express services in these areas.

So it's clear that there are no rigid distinctions among manufacturing, services and high-tech. To have a healthy economy, you have to recognize these various elements are inextricably linked and interdependent, and that each is important in its own right as well.

Services now yield more than half the gross national product in 14 of the most advanced countries. Those who question whether a "service economy" is possible are debating a moot case. For many nations, the service economy already is here.

In the United States, services now account for about two-thirds of our gross national product. In fact, 7 out of 10 Americans are service industry employees. You don't have to look far to witness the prominence of services' role in our economy.

Here in the Maryland-Delaware area, for instance, you'll find the headquarters of many Fortune 500 service companies. Like: IU International . . . PHH Group . . . Maryland National Corporation . . . First Maryland Bancorp. . . . Beneficial . . . U.S. Fidelity & Guaranty . . . Marriott . . . Giant Food . . . Mercantile Stores . . . and Columbia Gas System.

And let's not forget Johns Hopkins: Look at the foreign students there, and the medical treatment rendered to foreign patients. Those services are exports. We just have to change our mindsets to the new and true demographics of our economy.

On the international scene, services now represent from one-fifth to one-quarter of all trade—somewhere between $350 billion and $700 billion. The reason I'm so vague is that reliable figures simply do not exist. Governments, including our own, do not have accurate ways of measuring how big trade in services really is.

Even if our figures are bad, at least we can say that trade in services is big . . . very big . . . and has truly global impact.

The United States, Japan, France and Britain are the leading exporters of services . . . what the British call "invisibles." But the advanced countries are not the only ones that export services.

Hong Kong, for example, is the world's third largest financial center, which makes it a major exporter of services. Financial services also are the fastest growth sector of the Singapore economy. Brazil and India are even exporting computer software back to the Western nations.

The United States, however, is still the leading exporter of services, and that has been very important in offsetting our merchandise trade deficits.

The Commerce Department says that our trade balance in merchandise has been in deficit in 11 of the past 24 years. But in at least 6 of those years our trade in services has pulled the overall current account back into the black.

Despite that vigorous performance, we don't have to look hard to find signs of danger.

There was, for instance, an excellent article in Business Week earlier this year that warned that our service sector exports were in trouble.

Since 1981, the service sector net export surplus has shrunk by at least 20 percent, from $35 billion to $28 billion. The service trade surplus, which has offset the deficit in the trade of manufactured goods, is in decline.

A significant part of the problem arises from protectionist barriers and from the inability of international trade bodies to come to terms with trade in services. Trade in services is, in fact, not covered by the rules that regulate trading in goods. It is, therefore, open season on an increasingly large portion of international trade.

I recognize that there are times when barriers are legitimate. Trade in services affects some of the most sensitive areas of a nation's economy. Areas like finance, communications and transport can affect a nation's perception of its own sovereignty, of its ability to control its own destiny.

As the Economist magazine noted in its most recent issue [June 9–15]: "developing countries . . . protect their service industries in the cause of national prestige (air-

lines, shipping) as much as from commercial fear of foreign banks, accountancy firms and the like."

But I don't think the following kinds of barriers are justifiable—and this is just a tiny taste of obstacles that exist to full and open trade in services:

In Argentina, American accounting firms are limited in the number and type of audits they can perform.

In Italy, no foreign advertising agency is allowed to operate, and all TV commercials produced outside the country are forbidden.

In Germany, foreign telecommunications users are required to use certain domestic . . . and more expensive . . . leased lines.

So what is to be done, as Balzac once wrote. What is to be done?

This takes me into the third and concluding part of my commencement address.

Obviously, the problems I have described are massive and complex. Equally obvious is that they call for a massive and complex solution.

I do not pretend to have all the answers, but there are two specific ideas I'd like to put forth.

First, we need a new round of international trade negotiations under the GATT, the General Agreement on Tariffs and Trade. This was discussed at the recent London economic summit, but unfortunately they did not set a date for launching these negotiations.

Why should we launch new negotiations when we are in the middle of a protectionist trade war? Well, I believe that the best defense is a good offense. Unless we begin talking with each other about how to resist new protectionist measures, our trade conflicts will become worse.

The lessons of the 1930's tell us that protectionism leads to a vicious cycle of action and reaction.

To get out of a downward spiral, from which we all lose, we need to talk about getting trade moving again.

I believe in the bicycle theory of trade: Unless you are moving forward, you fall flat on your face.

A new GATT round could help overcome the trade barriers that have been thrown up in the past few years and those that loom ahead.

It would provide our political leaders with a reason to resist protectionism at home.

In addition to starting a new trade round, there are some very important steps we can take right here at home—30 miles away in Washington, D.C.

One of the biggest trade barriers to U.S. exporters today is the overvalued dollar.

The Administration and Congress can do something about that now.

The way is by reducing budget deficits, involving both a cut in spending and an increase in taxes.

A reduction in deficits will lower interest rates and bring the value of the dollar back down where it belongs.

Congress is now hammering away at a down payment, which is a good first step. But it should be quickly followed by a post-election session that will start work on a second round of deficit reductions.

In conclusion, those of you who are interested in exporting your goods and/or services should take a broad look at the environment in which you are operating.

We all know it's a tough environment. Believe me, it's a jungle out there.

But all of us here today can have an impact on that environment.

We can take steps to improve the trading picture. We can help improve the international competitiveness of U.S. industry.

I urge you all to help in that effort.

Thank you.

How to Use the Services of Sears World Trade: Partners in Export Development

(By Myron M. Miller, Baltimore, Md., June 18, 1984)

Whether you are already exporting, or whether you are considering exporting, you are undoubtedly interested in the kinds of services that will enable you to export in the most cost effective manner, and achieve the greatest possible international sales for the investment you make in exporting. The purpose of export trading companies, and general trading companies like Sears World Trade, is to help you achieve those objectives by providing value adding capabilities at costs considerably less than the costs of an individual company providing its own services.

We will look at some of the obstacles to overcome in exporting, what Sears World Trade is doing to develop services which overcome those obstacles, and how companies wanting to export can work with Sears World Trade.

I. WHAT IS SEARS WORLD TRADE?

Sears World Trade was formed early in 1982 as a general trading company, with intentions of becoming involved in exporting, importing, third country trade (that is, with no part of the transaction in the United States), countertrade, and management services. It was Sears intention to become a global company, driving from the great strengths in consumer products and light industrial products. Our initial charter was to deal only with consumer products and light industrial products. To our surprise we attracted inquiries from companies across the whole spectrum of American business, not just consumer products.

As we began to structure Sears World Trade, we found that there was no successful model to copy. The circumstances which brought Japanese trading companies into existence were unique to the needs of Japan at that time. Japanese business needed some capability to find the raw materials which were not available in Japan, and they needed to find markets for the output of their factories, markets beyond the limited needs of the Japanese market.

Japanese trading companies have expanded far beyond those initial roles. Those trading companies have considerable business in the United States, in fact, several of those companies have sales in excess of $10 billion, and are among the top exporters from the United States.

We also found that we couldn't copy the format of the European trading companies, though there are certain aspects of their activities that are worth considering. European trading companies have acted as the marketing arm for various manufacturers, particularly in countries where it was not economical for that manufacturer to set up its own marketing arm. In addition to performing the marketing role for manufacturers, European companies have become involved in commodity trading, and have been drawn into a wide variety of other businesses in the countries where they have substantial business. Their greatest strengths are in smaller countries, and in developing countries where manufacturers have chosen to put lower on their priority lists. For some countries, like the Netherlands and Denmark, trading was almost a necessity because the local markets were not sufficient to support sizable manufacturers, and they had to find export markets.

U.S. trading companies have tended to be small because the manufacturers step into the overseas marketing role when sales increase to a point where they can afford the investment in their own subsidiary. A number of U.S. export companies have developed up to about $60–$80 million, then grow no farther. Therefore, we realized we would have to be different if we were to become a large, world wide trading company that could hold on to its clients for many years.

Considering that there was no exact model to copy, we recognized that we were going to have to develop a different type of trading company. We also had to recognize that we were forming our trading company at a time when severe obstacles were developing in world trade, restrictions in trade caused by the indebtedness of many countries, compounded by the ever strengthening U.S. dollar. Despite those obstacles, or perhaps because of them there is an increased awareness of the desirability of trading internationally by U.S. companies. The increased desire to participate in international trade is not unique to the United States. Therefore, there is even greater opportunity for a company like Sears World Trade, which intends to operate globally.

The world is in a time of crisis in international trade, but here we have something to learn from the Chinese. Their symbol for our word crisis is made up of two characters put together to make the one charcter for the word crisis, and those two separate characters represent "danger" and "opportunity." We are focusing on the "opportunity" part of the crisis, not on the "danger" part of the crisis.

The structure and direction of Sears World Trade, therefore, is being shaped by the fact that there is no clear role model for us, by the opportunities arising from the crises in international trade, and by the particular strengths of Sears Roebuck and Company. The latter, which I shall discuss later, provides Sears with an opportunity for a very unique role among American corporations. In our search for the best structure, we have gone back to the fundamentals of doing business internationally, by looking at the needs of companies participating in international trade and determining how we could involve ourselves with them as a trading intermediary. We want to earn our way into their spectrum of business activities by adding

value to their business, performing those activities more efficiently than they can themselves.

II. THE FUNDAMENTALS OF TRADING

Any business earns its profit by adding value to an end product or service. The more value one adds in producing, selling and servicing a product, the greater the margin one earns. Some companies add very little value in producing an end product. They may only assemble a product, sell it through some intermediary to an end user, and not be involved in servicing the product, nor in financing its sale. On the other hand, there are some companies that are very vertically integrated, and do almost everything themselves.

A good example of a company which added a great deal of value to a product was one of my former companies, the Singer Company. For most of its history, until the last 10 or 15 years, the Singer Company probably added more value to a sewing machine than anyone had ever added to a product. In obtaining raw materials, they even owned 30 million acres of timber in Canada to supply the lumber for their sewing cabinets. They did all of their own research and development work, and manufactured virtually every part of the sewing machine in over 30 factories scattered throughout the world. If one couldn't sell in a country, then they put a factory there, as they did in countries like Brazil, Mexico, Turkey, and Pakistan. As vertically integrated as they were in R & D, sourcing, and manufacturing, they were equally integrated in marketing. They sold entirely through their own stores at one time, and had as many as 1,700 stores in the United States in the early 1970's.

Singer often sold its products door to door, and then handled the entire credit and collection process themselves. By performing all these value adding functions, Singer earned a very high gross margin, but the cost and investment involved in adding all that value was very significant.

Let's look at the spectrum of value adding activities, and the kind of margins earned by those activities. I must qualify these figures by saying that they weren't derived from exhaustive study; rather, they are based on my personal experience and are only meant to provide an understanding of the value added process. The following example represents two companies in the consumer durables business, each with very different degrees of value added:

Value adding activities—consumer durables companies

	Percent
Sourcing of raw materials and other components	2–4
Research and development	3–8
Manufacturing and/or sourcing finished products	3–8
Information and communications	2–4
Shipping and other cargo management functions	2–3
Taking title to inventory/warehousing	3–6
Finance insurance	2–4
Marketing and sales	5–10
After sales service	3–6
Total gross margin—depends on degree of vertical integration, i.e., value added	25–53

The 25 percent gross margin is typical of many consumer products companies, because their value added, while significant, is limited to the areas where it matters most for the company to be distinctive. The higher percentage shown above represents a company which is quite vertically integrated. The greater the degree of value added, the greater the costs and investment to support that value added.

This is the profile for a consumer durables company. Each industry has its own profile. Companies that require a high degree of technology would earn a greater portion of their gross margin by adding value in the research and development function. The cosmetics companies would earn a greater relative percentage of their gross margin from value added in marketing.

If a trading company, as a trade intermediary, is to have a role, it must understand the value adding functions of a potential customer, and find a way to add value in certain functions better than the company can itself.

III. TYPES OF TRADING COMPANIES

In developing our capabilities, we have looked at the types of services offered by other trading companies. A trading company chooses the kinds of value adding ca-

pabilities it wants to develop to assist its customers. We have observed the following general types of trading companies.

Brokers, who earn their margins by putting a buyer and seller together, but do little more than that. One doesn't have to know much about specific products or their applications to be a broker. The broker role involves having good contacts in the world of buyers and sellers.

The risks for a broker are that by adding such little value he risks being replaced by someone who adds more value. The rewards are gross margins of 2–6 percent of sales for providing the matchmaker role.

Commodity traders are different from "traders" in manufactured or processed goods, as one might recognize, but they can earn a good margin by their financing and cargo management abilities. The rewards are good in good times, but the volatility of commodity markets makes the role of a trader very risky.

Marketing/brand oriented traders. The European trading companies have taken on more and more value adding roles in recent years, particularly in marketing and after sales service. The good marketing oriented trading companies can earn up to 20–25 percent gross margin by adding value in carrying inventory (of selected products and high mortality parts), marketing and selling, and providing excellent after sales service.

Trading companies which integrate themselves to provide greater value to their customers and to secure long term trading relationships. Some of the Japanese trading companies, like Mitsubishi, have integrated into manufacturing, and have taken ownership of raw material sources. Those companies are now buying portions of venture capital supported companies to secure long term positions with those companies. These additional value adding functions earn them higher margins, but only at the expense of the problems associated with greater investment and higher costs.

Given this overview of the roles of the trading companies, Sears World Trade has been shaping a trading company that will have some similarities to other types of trading companies, but unique because of how we choose our value adding capabilities.

IV. SERVICES PROVIDED BY SEARS WORLD TRADE

Let's review again the list of value adding functions:
Sourcing of raw materials and other components.
Research and development.
Manufacturing and/or sourcing finished products.
Information and communications.
Shipping and other cargo management functions.
Taking title to inventory/warehousing.
Finance insurance.
Marketing and sales.
After sales service.

In deciding which of these services Sears World Trade would perform for its customers, we examined the particular strengths which already exist in the various components of Sears, Roebuck and Company. Some of the particular strengths of Sears are:

Sourcing skills. The Sears Merchandise Group has 11,000 suppliers in the United States and several thousand more throughout the rest of the world. The experience of buying for the vast retail organizations of Sears in the United States, Canada, and Mexico has developed great capabilities for use in sourcing for other companes. Because we buy hundreds of thousands of products per year from some of our suppliers, we are able to use that buying leverage to our advantage in buying products for others.

We also have experience in buying components, though not to quite the same extent as we do finished products.

Research and development, and manufacturing. Although Sears does not do original R&D, and does not manufacture, it does determine the product line structure and the specifications for its products, therefore has great product management skills. Also, since Sears must test all products in the Sears Laboratory before they qualify to be sold in Sears stores, and because Sears works with manufacturers to be sure that the factory is capable of high quality products at reasonable costs, and can ship those products on time, we know a great deal about manufacturing through the world. We often help manufacturers increase their capabilities so they can meet our standards, which enables them to become internationally viable.

In the areas of shipping and cargo management, we had the experience of buying $1 billion at F.O.B. from 46 countries, and shipping those goods to the United

States. From that we have learned a great deal about international shipping, and have also gained great economies of scale.

While our marketing experience has been limited primarily to consumer products, we have great knowledge in that area, and the basic market know-how that will give us a reasonable start in several other important product areas (like agribusiness, for example).

Based on these strengths, and the value adding services we thought were essential to provide to our customers if we were to compete globally, we decided on the following areas as those where we would develop our resources. Without going into detail about all these services, we decided on the following:

1. Financial Services: Trade finance; international cash management; foreign exchange management; documentary services; and countertrade.
2. Market Evaluation and Selling Services: Pre-trade advisory services; export advisory services; selling products; and countertrade.
3. Sourcing services.
4. Cargo Management Services: Freight documentary services packaging and insurance; freight movement; and warehousing.
5. Technical Services: Technology transfer service; and trade advisory services.

Note that we do not intend to manufacture products ourselves, nor will we do extensive R&D work in any product area, though we will be involved in managing product lines and specifying products.

In addition to these more traditional services, we are giving particular emphasis to developing capabilities required by the global role we intend to play, and because of the disruptive forces working against the free flow of trade today:

Information and communications. We have decided that we had to have information capabilities second to none in the world, so we are putting into place an excellent communications network, which will enable our offices throughout the world to communicate within a matter of hours.

Countertrade. This was mentioned above, but with an increasing trend toward countertrade throughout the world, we must be prepared to participate.

Project finance. Little can happen in international trade without creative expertise in project finance.

Project management. This involves the ability to take a systems, or turnkey approach to major projects, all of which result in the flow of goods into the world markets.

Government procurement. We have unique knowledge of how government procurement is handled in the United States and are able to assist others in that process.

Our intent in developing all these services is to assist our customers by adding value to their activities more economically than they can do it themselves.

A starting point in our work with a customer is the development of an understanding of what the value adding functions cost that company. How much will it cost that company to develop its own internal purchasing capability?

How much will it cost to set up an export department? How much would it cost them to set up their own overseas marketing capability? Or to set up a countertrade department? How much would it cost them to set up their own trade finance capability, or how much would it cost them to use the services of those who sell trade finance services? What are the costs of their cargo management services?

Before dealing with those issues, let me describe the areas of product and functional service capability we are developing.

V. BUSINESS GROUPS OF SEARS WORLD TRADE

The business groups of Sears World Trade consist of the following:

Commodity trading—the trading or brokerage of raw materials and undifferentiated bulk products.

We have had a limited number of traders involved in this activity for almost a year, learning what is required to be successful in this field.

General trading—expert sourcing and marketing of differentiated goods, i.e., manufactured and processed products.

This is the area where we have had our greatest experience, particularly in consumer products. We are gaining experience in processed goods, a very promising field. The fields of health care and technology are of considerable interest to us.

Technical services—consulting, project management and technology transfer services related to international commerce.

This is an area where we have great strength already. Harbridge House, the Boston based consulting company, is a part of Sears World Trade, and brings to us

37 years of consulting experience, much of it trade related, and a thousand satisfied clients. We have recently developed, as a new subsidiary of Harbridge House, the International Planning and Analysis Center, which provides us with significant trade related advisory capabilities, both on the macro and micro economic levels. Further, we have a Management and Technical Services Group, where we have organized the know how of the Sears Merchandising Group and supplemented that with some new people who have the ability to provide know how to retail and manufacturing companies to upgrade their skills.

Some of our most exciting projects fall into the technical services area. The advisory services we have sold to retailers throughout the world, particularly in Southeast Asia, are particularly impressive. And the services we are now providing to manufacturers in Mexico, for example, are helping companies to upgrade their capabilities and their products to international standards.

Logistical services—transportation, communications and data or transactional processing services in support of international commerce.

This is a recent area of emphasis for Sears World Trade, but it already includes Sears-Schenker Services, a joint venture established late in 1983 to enhance our capabilities in the cargo management field.

Countertrade—structuring, negotiating, and managing of trading transactions and projects in the fulfillment of countertrade obligations.

Since Sears World Trade was founded in 1982, we have been presented with a mind boggling array of opportunities, ranging across every conceivable type of product or service. It has not been easy to say "no" to some of the opportunities presented to us, but we have had to focus our efforts because, as large as Sears Roebuck is, Sears World Trade must stand on its own, and our resources are not limitless! Thus, we have chosen to focus on the business groups described here. Even within these areas, we are forced to focus our resources, so we will still have to say "no" to many opportunities for some time to come.

At this point I would like to point out that we have no intention of being the only player in the United States in the field of international trade. Therefore, we need to be one of the partners in export development. There is so much to be done, particularly in developing exports from the United States, that there is an important role to be played by many others.

VI. HOW COMPANIES CAN WORK WITH A TRADING COMPANY LIKE SEARS WORLD TRADE

With all that I've said about trading companies and their role, and about Sears World Trade, what does that mean to many of you, who either are exporting today and would like some help in expanding their base, or those of you who have done little or no exporting.

Here are a few suggestions on how you might work with us, or prepare to work with us at some point in the future:

Relating back to the value added functions described earlier, it is advisable to study your own value adding activities, and determine what contribution each activity makes to your total gross margin. You must also look at the costs and investment associated with those value adding functions. Then determine which of those you feel are most critical to making you unique, and which others are not so necessary to do yourself, and where the latter could be done more economically by an outsider, like a trading company.

If you have to incur significant costs to do your own financing, or to do the logistical services yourself, you could consider having us arrange that for you. Without an understanding of what you should do yourself, and what you do best, you may not be in a very good position to work with a company like ours. We have the kinds of advisory services that can help you make that assessment.

If you are considering exporting, or have limited experience in it, determine how much it will cost you to get into the game. As part of our effort to provide services for others, we have been analyzing the costs for a company to do certain exporting activities themselves. An example of the costs required to set up an export department, for example, is the following:

Export sales manager	$65,000
Export sales representative	35,000
Administrative assistant	15,000
Travel and entertainment	60,000
Promotion and advertising	35,000
Telephone and telex	15,000
General and administrative	15,000
Total fixed costs	240,000

There is a lot of room to argue these figures, so they are only meant to illustrate the kind of analysis you should make of your own requirements to get into exporting. These are only a part of the costs and investment required to export. Some additional costs to consider are:

Incremental R&D and manufacturing costs required to make products suitable for international markets.

Incremental costs in finance departments to handle problems associated with foreign currencies, overseas banks, etc.

Incremental warehousing costs to isolate goods destined for international shipment.

Incremental costs involved in export packaging, packing, and shipping.

Incremental costs in accounting department to handle all aspects of international business.

If you are willing to make this analysis, then we are in a better position to work with you, for we can then determine the ways we can save you money in most of those areas.

In developing our capabilities to work with many of you, we are making these analyses ourselves, so we can find the ways to lower costs for various functions, and do it on a large enough scale that we make those costs lower for large groups of customers. It is going to take time to develop the means to "mass merchandise" those capabilities. We want to drastically alter the cost structures for those who want to be involved in international trade, and we want to perform services at considerably lower costs than companies would incur themselves.

You can prepare yourself for exporting by attending export seminars like this, to learn from others who face similar problems.

Using other partners in the export development business. I said that we can't do it all ourselves. There is a great deal of help you can get from the International Trade Administration section of the Department of Commerce. They are a great aid to companies just beginning to export. There are more and more banks developing international trade finance capabilities, and they can be very valuable. Some time ago, those services were the province of the large banks in major cities, but that is changing. There are export trading companies who have particular expertise in certain industries, who can be very helpful. We find ourselves working in partnership with other trading companies since we all realize we can't handle every opportunity ourselves.

Finally, you can work with us now in areas where we have already developed considerable capabilities. In areas like consumer products, countertrade, pre-trade advisory services, cargo management and finance, we are equipped today to service many of you.

In conclusion, I hope you have some better perspectives of trading companies, and Sears World Trade in particular. I hope you may also be able to leave here today with some concrete ideas of how you might prepare to work with a trading company. It takes a lot of analysis of your operations to know where a trading company might do something better or more economically than you can, and it takes commitment and perserverance to get into and stay in the exporting business. The rewards, however, are well worth the effort and risks you put into developing export business.

Area Banking Services From the Perspective of a Regional Banker

(By Rafael J. Diaz-Balart, the National Bank of Washington, June 18, 1984)

I have been asked to give an overview of banking services available to the region for exporters. I will do so from the perspective of my institution concentrating on what I believe are the types of services that need to be granted currently in order to help our area's exporters in an adverse period while highlighting the unique opportunities that exist in the region which our area's exporters and financials institution can exploit to their advantage.

The National Bank of Washington has had an international department that has been active in financing trade for many years. Established and well run international departments exist as well in the major Washington and Baltimore Banks—these numbering in excess of one dozen—and in addition to the domestic banks, around 15 foreign banks also have some type of presence in the region—whether as a branch

or representative office. All these institutions have been financing trade in varying degrees. Whether financing short term transactions, be it through letters of credit and bankers acceptances, or medium and long term transactions for financing capital goods exports and overseas projects where domestic companies are engaged, the area's banks have contributed substantially to the promotion of the exports of U.S. goods and services.

During the period of high worldwide economic growth and large OPEC surpluses, the area's exporters were helped significantly by the direct financing of importers that occurred. However, the current international climate has forced banks everywhere to be very careful in the extension of international credit—especially to the LDC's—where a substantial portion of our manufactured goods have been traditionally sold. This factor, the hard currency constraints being experienced by the LDC's and also the high priced dollar, have created a very difficult situation for our exporters, as evidenced by the record trade deficits the United States is now experiencing.

We all know that economic cycles exist and currency values are not static. But currently there are some structural problems that affect the price of the dollar and the ability of the LDC's to resume substantial growth patterns. Although the domestic budget deficits and the world debt problem are being addressed, these are problems that seem to be with us for some time, and as a result, U.S. exporters will face an adverse climate until long term solutions are implemented.

In light of this climate, then what services need to be granted by financial institutions to ensure that U.S. exports take place?

Financial institutions must put together the best possible financial packages in order to ensure that our exporters compete in this field since the value of the dollar does not help them. However, commercial banks must obtain the needed level of comfort in what is now perceived as a riskier world. I believe that the Baltimore-Washington area banks and exporters have an advantage in overcoming the challenge of exporting in spite of a less than perfect climate.

Let me say a few words about the uniqueness of this area:

The Baltimore-Washington area which is the nation's fourth largest regional market has a noted diverse and balances mix of commerce and industry—from the traditional smokestack industries to the hightech service ones. Its communication facilities are excellent including America's third largest port, the port of Baltimore. But in addition, the region is the headquarters to the multilateral financial organizations such as the World Bank and the InterAmerican Development Bank; the headquarters for the U.S. Government agencies which aid in promoting U.S. trade, such as OPIC and the Eximbank, and being the nation's capital, Washington is home for over 140 Embassies.

The region has all the above, yet industry and commerce are predominantly in Baltimore and the Exim and World Banks are in Washington. In how successfully we manage to integrate the resources of the area's unique institutions, financial and entrepeneurial wealth, is the key to how the area can exploit its undoubted "comparative advantage" to its benefit.

The senior management of The National Bank of Washington has made a commitment to regionalizing the bank to promote the uniqueness of the Baltimore-Washington region. Our first Loan Production Office was opened last year in Baltimore and at the beginning of June the bank's first Edge Act Subsidiary—NBW International Banking Corporation was opened also in Baltimore. The Edge Act Corporation is exclusively devoted to the handling of international business, and it is the first such corporation of a Washington based bank to open in Baltimore. Other area banks have committed themselves to developing the Baltimore-Washington region, and this can only translate into better opportunities for all in the area.

But now let me return to the challenge being confronted by the area exporters and banks.

As I mentioned, the ability to integrate area resources unique to the Baltimore-Washington region is the key to our comparative advantage, and for a bank that means management services. Our international financial products are basically similar. How we package them differently is what differentiates one bank from another and how one exporter may succeed and another may not. That is to say, the specific problem of the exporter must be identified and dealt with the appropriate tools so that proper financing is obtained in the context of desired comfort levels for the bank.

I would like to give two examples of how NBW has been working with exporting firms in collaboration with U.S. Government agencies to ensure their success.

The National Bank of Washington has been assisting a large independent export trading company involved primarily on the procurement side, buying specially for

large overseas project at a time. It is apparent that the most profitable and economically viable business opportunity for this firm is large procurement contracts covered by extended performance guarantees.

Large procurement projects are characteristically credit-intensive, requiring credit prior to the transaction through bid and performance bonds, during the execution of the trade transaction through commercial letters of credit, and after the transaction due to the extended terms and warranties. An independent ETC must continually stretch initial working capital resources since the returns from previous procurement projects may not prove adequate to support succeeding efforts, especially on the larger and more profitable projects. Ordinary supplier financing is a necessary but not sufficient funding source. Without access to supplementary financial resources, an independent ETC will likely suffer a contracted backlog, lost or postponed business opportunities and a consequent inability to sustain normal growth. The unique funding requirements of an ETC involved in large project procurements have not been dealt with comfortably by commercial bankers. Their comfort level with respect to an ETC's credit capacity is quickly reached and is usually short of the basic needs of an independent ETC.

We have identified the Eximbank's Working Capital Guarantee Program to assist this customer of ours in obtaining the necessary financing in view of the double financing that ETC's are subject to. Although the transaction has not been finalized, we have been able to identify a valuable program for our customer which in essence has the Eximbank shifting from guaranteeing the foreign receivable to guaranteeing the performance of the U.S. exporter.

The second example is the package we put together for Systems and Applied Services Corporation (SASC) of Tysons Corner, Virginia.

Foreign buyers of U.S. service contracts usually require the contractor to provide both performance bond guaranties for a large part of the contract cost and advance or progress payment guaranties protecting payments by the project owner to the U.S. contractor.

These burdensome credit demand, like the aforementioned double funding required from the ETC's with large contracts, often exceed the contractors' working capital resources. And, at a time when commercial banks are wary of export financing risks, the contractor may not be able to secure additional credit from private banking sources. Such a shortage of credit for the contractor causes a contraction in backlog and lost or postponed business opportunities with a consequent inability to sustain normal growth.

The Systems and Applied Sciences Corporation (SASC) of Tyson's Corner, Virginia, which develops new aerospace and computer software technologies, was a small contractor which faced just this type of credit shortage. SASC was engaging in its first very large contract, and it was entering a new market—the People's Republic of China. Such an ambitious venture seemed to be the perfect opportunity for assistance from the government export-assistance programs.

OPIC's recently developed Small Contractors Guaranty Program was created to provide support for commercial bank financing of small U.S. construction and other service contractors, including "turn-key" projects.

The program represents an innovation in OPIC functions because it combines the more traditional investment insurance with elements of export financing. The Small Contractors' Guaranty Program had not been used until the National Bank of Washington proposed to OPIC that it appeared to fulfill the financing needs of SASC.

The program provides a guaranty to the issuing commercial bank for the punctual reimbursement by the U.S. contractor of up to 75 percent of any drawings under the aforementioned stand-by letters of credit. The bank, The National Bank of Washington in this case, retains the remaining 25 percent of the letter of credit exposure. Thus, the performance of the U.S. exporter is being guaranteed by OPIC.

Additionally, the program provides time for the contractor to resolve the underlying contract dispute with the foreign project owner by allowing OPIC to suspend the contractor's obligation to repay immediately the amounts of the drawings under the standby letters of credit, pending a full inquiry into whether the drawing was justified or arbitrary and pending recourse by the contractor to the dispute resolution mechanisms contained in the underlying contract between the contractor and the foreign project owner. Of course, the contractor and his bank can also add OPIC's standard political insurance.

Seeing that this program was ideally suited to the needs of SASC, The National Bank of Washington was able to organize the loan's collateral in a manner acceptable to OPIC.

In conclusion, the area financial institutions can best help the exporter by being liaison between the region's unique institutional resources in addition to providing the traditional banking services. Our Edge Act subsidiary in Baltimore is geared to provide those management services to the area's small and medium sized companies engaged in exporting, in order to meet the challenge confronting today's Baltimore-Washington area exporters.

Private Sector Services for Export Promotion Banking and Insurance Services

(By Joseph J. Tamulis, Vice President/Manager, Marine Department, Alexander & Alexander, Inc., Baltimore, MD, June 18, 1984)

(I) TRADE AND INSURANCE

There has been an inter-relationship between Trade and Insurance throughout the history of civilization, dating back to the origin of trading activities in ancient China. Until recent years, the body of commerce, trade practices, and international law were an attempt to establish equity and predictability, and certainty in relation to international trade. Prior to the development of formal insurance, the principles of admiralty, the laws of the seas, were developed and are similar to the practices now incorporated in modern transportation insurance.

As the sophistication of commerce and modes of transportation became increasingly complex, the body of insurance practice also grew in its intricacies.

While modern insurance remains a contract of indemnity attempting to place the innocent insured in a position he would have been had no loss occurred, there remains tremendous variance in the scope of coverage being afforded by the many competing world Underwriters.

Foreign Trade Insurance Practices represent an inter-relationship between Merchants, Bankers, and Underwriters and there is a mutuality of purpose creating the necessity of clear understanding between these various parties. Those involved in Foreign Trade must not only be aware of the considerations for each of these parties but, also, must be aware of Foreign Custom and Foreign Law. While the subject matter of these insurances deals with the specific commodities moving in international trade, there is an increasing awareness that many varied types of insurance are necessary, in order to provide full protection of assets represented by the merchandise in transit.

Quite truly, the merchant is at risk from the time he invests in raw materials and until such time as the financial transaction is completed and the funds are deposited in the merchant's account. Insurance has progressed from a point where the merchant sought protection for losses caused by the "Perils of the Seas" to a point where he is now concerned with not only physical losses, but political losses and credit losses.

(II) PRIVATE SECTOR INSURANCE SERVICES

Since there is little required uniformity in respect to contracts for international trade, Private Sector Insurance Services must involve more than simply the issuance of insurance contracts. Strictly defined, an Insurance Broker is the client's representative and a "good" broker is normally expected to provide a wide range of services, which include Insurance, Risk Management, Financial Analysis, Loss Control, and Claims Services for the client.

While many shippers have similar exposures, each situation requires individual analysis and insurances tailored to specific needs. We have not attempted to provide general solutions to your specific problems; but rather, to highlight areas of concern and sources to approach for information on your current and changing problems.

Key Terms:

The Venture—An opportunity for profit or a chance of loss.

The Merchant—The venture creator and risk producer.

The Banker—Provides wherewithal for venture capital; sets security standards for acceptance.

The Underwriter—The risk taker/his judgment in evaluation of the hazards or the venture produces the insurance premium.

The Assured—The party seeking insurance could be the merchant and/or the banker.

The Broker—The assured's representative negotiates coverage with multiple Underwriters; can bind insurance coverage only on approval of the Underwriter.

The Agent—The Underwriter's representative offers coverage to the Assured.

The Direct Writer—A single Underwriter, who does not use independent agents or brokers and offers coverage direct to the Assured.

POLITICAL/EXPORT CREDIT RISKS—FINANCIAL SERVICES AND SPECIAL CAPABILITIES

Widespread political instabilities.—Political, economic, monetary and military instabilities in many areas of the world are of concern to the international business community. For many of our clients—foreign investors, overseas contractors and exporters of products and services—these instabilities can give rise to political or credit losses sufficient to cause serious disruptions in corporate financial positions.

The A&A approach.—Our initial, and often difficult task, is *Risk Identification.* As discussed in more detail below, our risk identification efforts are directed into four separable, often interrelated, categories, as outlined in our Political/Export Credit Risks brochure. They are:

Foreign investments.

Overseas contracts.

Sale of specialized products—pre-shipment risks.

Sale of products or services—post-shipment risks.

Following risk identification, and where feasible, suggestions for *Risk Amelioration,* our specialists begin to explore the various *Risk Transfer* alternatives, including one or more of the following:

Government-sponsored insurance facilities:

Overseas Private Investment Corporation (OPIC). Export-Import Bank of the United States (Eximbank). Foreign Credit Insurance Association (FCIA). Counterpart Organizations Overseas.

Private-sector insurance facilities, primarily Lloyd's Underwriters (Lloyd's) and American International Group (AIG).

Noninsurance facilities, such as commercial banks, nonbank financial institutions or export management companies.

To the extent that Risk Transfer is impractical or impossible to attain adequately, our specialists will also be prepared to discuss various Risk Retention techniques.

Causes of loss by categories or risk.—The following are the principal causes of loss associated with the four major categories of risk identified above:

Foreign investments.—Investors in foreign facilities situated in politically unstable countries should be concerned about the major causes of political risk loss, namely:

Expropriation. Essentially, the taking of an asset or enterprise by a foreign government without prompt, adequate and effective compensation.

Inconvertibility. The imposition by a host government of restrictions on the repatriation of earnings, debt service or fees.

War damage. Physical damage to overseas properties caused by war, revolution or insurrection (Where the asset or enterprise is fixed and land-based, war-risk protection is available only through government-sponsored insurance facilities.)

Overseas contracts.—Contractors operating overseas—architects, designers, engineers, builders, owners or lessors of equipment, among others—often encounter a wide variety of political/export credit risk potentials. The most significant of these include:

On-demand bank guarantees. Utilized in place of surety bonds, on-demand bank guarantees are callable at the sole discretion of the foreign beneficiaries. These guarantees are potentially vulnerable to loss, especially in the event of a political upheaval in the host country.

Contract repudiation—public buyers. The loss potentials in this area tend to be greater where there are substantial demobilization expenses which may not be fully recoverable and where the underlying contract calls for binding arbitration in the host country.

Confiscation, deprivation—mobile equipment. The contractor could encounter difficulty when attempting to remove equipment from the host country, especially where a hostile government has supplanted a friendly government.

Contract termination—force majeure. Where the underlying contract is terminated in accordance with the force majeure provisions, the contractor may find that the right to recovery from the host country is inadequate or that the remaining receivables are uncollectible, or both.

Payment defaults. Receivables may be uncollectible due to commercial or political causes in connection with debts incurred under overseas contracts with public or private entities.

Sale of specialized products—pre-shipment risks.—The manufacturer of specialized products—fabricated for delivery into unstable markets overseas and not readily re-

saleable to others without substantial loss—may encounter many of the same types of loss potentials as do overseas contractors. The most significant of these are:

On-demand bank guarantees; contract terminations; export or import embargoes.

Sales of products or services—post-shipment risks.—The risks of loss in this category correspond, in large measure, to the risks insurable under typical export credit insurance policies of FCIA, most notably:

Transfer risks; other political risks; insolvency; protracted default.

A&A operational procedures.—Because of the complexities associated with the various risk identification, risk amelioration, risk transfer and risk retention techniques employed in the servicing of political/export credit risks, Alexander & Alexander centralizes its administrative functions in these areas through its Foreign Credit Division. Operating cooperatively with all A&A offices throughout the country, the Foreign Credit Division supplies the professional input needed to service effectively the requirements of our clients in these unusual areas of risk.

Additional information on this subject can be secured from any A&A office or from the Foreign Credit Division:

New York Headquarters.—1185 Avenue of the Americas, New York, N.Y. 10036, (212) 575-8000, Telex: 12-5853.

Chicago Office.—175 East Delaware Place, Chicago, Illinois 60611, (312) 545-3223, TWX: 910-221-5005.

MARINE INSURANCE—GENERAL INSURANCE SERVICES

Marine insurance is the oldest form of insurance, and today one of the most complex. In addition to ever-present liability exposures, the varied interests (cargo, hull, machinery and fright for example) of those involved in transportation require sophisticated solutions to insurance problems.

Across the oceans, on inland waters and overland, Alexander & Alexander has been helping the marine industry protect people, property and profits for more than three quarters of a century.

A&A's bottom line orientation.—Our objective is to provide our marine clients with profit protection at the most economical cost, while ensuring cash flow continuity. To do this, we first complete a careful analysis of the exposures. Based on our findings we may recommend more insurance, less insurance or self-insurance. We investigate captives and self-retention programs. Whatever the solution, our recommendations are based on a combination of the client's requirements and our knowledge and expertise.

Dealing with losses.—From a client's point of view—and ours—the best way to deal with losses is to prevent them. Before we even consider insurance alternatives, our marine professionals look for ways to eliminate or reduce risk exposures. If necessary, our loss control specialists and professional engineers complete on-site inspections and recommend ways to cut insurance costs.

When a loss occurs, A&A's claims and average adjusting facilities serve clients on a round-the-clock basis. The A&A people handling a client's claim are marine experts. These people know the client's business, and the importance of cash flow conservation. They help expedite cash settlements and shorten litigation—whether it's a routine physical damage claim or a complex general average adjustment. A&A's claims services include:

Loss evaluation; contract analysis; general average adjusting; computerized claims analysis; claims expediting

Pioneers in new marine insurance concepts.—Alexander & Alexander has been a recognized leader in the marine insurance business for many years, and our people have designed and developed new concepts, such as LASH barge coverages which are now industry standards. A&A's marine professionals assist clients with a wide variety of coverages, including:

Vessel insurance.—Hull and machinery; protection and indemnity charterer's liability; terminal operators coverage; offshore drilling, including platform, cost of control and pollution liability; builder's risk protection (shipyards); bumbershoot and excess marine liabilities.

Cargo coverages.—Legal liability; container protection; collect freight insurance; waiver of subrogation; warehouse liability.

Special capabilities.—River transportation; tugs and harborcraft; commercial fishing fleets; marinas.

BONDS

Performance and payment bonds.—For many years, A&A has distinguished itself as a creative, resourceful leader in procuring surety bonds for construction contrac-

tors, and other. Such bonds are vital to the existence of most contractors. Our clients' requirements are often unique and cover both international and U.S. operations.

A&A's strength in the field of construction bonding is found in the quality and depth of its international network of highly experienced surety bond specialists who know the construction business and work from their client's point of view. Also, A&A's leadership position in this highly specialized field of surety credit offers us the advantage of access to the broadest scope of markets found anywhere.

The A&A professional approach calls for a comprehensive understanding of the client's operations and situations that require bonds. A complete management overview is prepared for marketing that includes details of the client's goals, corporate structure, management methods, key personel, accounting, estimating and cost controls, and project planning. We believe such an understanding lets us communicate in the marketplace to develop the best, most effective surety bond program.

Also, through A&A's international network of surety bond and insurance specialists, we can provide service and information regarding local conditions for contractors bidding jobs in areas of the world with which the contractors are not familiar.

Fidelity bonds.—Although employee fraud and dishonesty is a glaring national concern, costing employers millions of dollars in loss, it is an area of glaring underinsurance. The complexities of doing business nowadays creates increasing opportunities for employee fraud and dishonesty losses. Our A&A specialists apply their expertise in satisfying a clients concern for adequate coverage, limits of insurance and means to minimize premium costs. While standard policy forms may satisfy most client needs, there are many instances where special tailor-made policies must be developed to satisfy a client's unique risk exposures. It is by working closely with our clients in understanding their coverage needs that we can develop the most effective crime insurance program for them.

(III) EXPORT TRADE CONSIDERATIONS

"Those experienced in international trade recognize that every export sale is 'C.I.F.', no matter what terms are actually spelled out in the sales contract. While the exporter can point to the fine print and legally deny responsibility for any problems that arise, his doing so will in most cases automatically preclude future business with the customer involved. If he's lucky, the exporter receives payment and loses the account. Less fortunate suppliers find themselves holding unhonored bank drafts for merchandise lying on piers thousands of miles away." (African News Digest Farrel Lines.)

In export trade, there is wide variance in terms of sale and in insurance coverage, C.I.F. (Cost Insurance and Freight) obligates the buyer to furnish insurance; however, C.I.F. does not specify the extent of insurance furnished, and each sale should be evaluated in light of the commercial transaction and what risk of loss remains after the terms of sale and the terms of insurance are set.

(A) Terms of Sale:

Incoterms: The International Chamber of Commerce, 1212 Avenue of the Americas, New York, N.Y. 10036, (212) 354-4480.

(B) Average Conditions: Summary of scope of insurance coverage

AVERAGE CONDITIONS SUMMARY

Insuring condition	Coverage—Basic perils are: Of the seas, fire, assailing thieves, jettison and barratry.	
	Total loss	Partial loss
T.L.O.: This Insurance is against the risk of total and constructive total loss only.	Basic Perils	None.
F.P.A. (American conditions): Free of particular average unless caused by the vessel being stranded, sunk, burnt, on fire or in collision.	do	Caused by stranding, sinking, burning or collision with another vessel.
F.P.A. (English conditions): Free of particular average, unless the vessel be stranded, sunk, burnt, on fire or in collision.	do	If the vessel be stranded, sunk, burnt, on fire or in collision with another vessel.

AVERAGE CONDITIONS SUMMARY—Continued

Insuring condition	Coverage—Basic perils are: Of the seas, fire, assailing thieves, jettison and barratry.	
	Total loss	Partial loss
With average (3 percent average): Free of particular average under three percent (3 percent) unless general, or the vessel be stranded, sunk, burnt, on fire or in collision, each case or shipping package separately insured.	.....do.....	if amounting to 3 percent or more. Under 3 percent if vessel be stranded, sunk, burnt, on fire or in collision with another vessel.
Average irrespective of percentage (named perils): Subject to particular average irrespective of percentage, including the risks of theft, pilferage, non-delivery, fresch water damage, sweat and steam of steamer's hold, bale hook damage, contact with fuel oil and other cargo, irrespective of percentage.	Basic perils and other named perils.	Basic perils and others named.
All risks: To cover against all risks of physical loss or damage from any external cause irrespective of percentage, but excluding, nevertheless, the risk of war, strikes, riots, seizure, detention and other risks, excluded by the F.C.&S. (free of capture and seizure) warranty and the S.R.&C.C. (strikes, riots and civil commotions) warranty in this policy, excepting to the extent that such risks are specifically covered by endorsement.	However caused except those excluded.	However caused except those excluded.

BROKER SELECTION CRITERIA

(1) Security and Financial Strength: Volume of Business; Range of Clients; Profitability of Operations; Stability in Community.

(2) Organizational Structure: Management Philosophies; Local, National and International; Office Size; Qualifications of Key Individuals/Account Responsibilities; Attitude of the Firm; Professionalism.

(3) Service Capabilities: Market Knowledge (domestic and worldwide); Specialty expertise; Client Knowledge; Client Goals and Objectives; Market Representation/Use; Funding Alternatives; Risk Management Capabilities—Program Development, Reserve Analysis, Loss Forecasts, Retention Analysis, Captive Abilities, Reporting Systems; Loss Prevention/Control Services; Quality Assurance Capabilities; Claims Administration.

(4) Creativity: Presentation Techniques; Coverage Development; Alternatives; Depth of Proposal; Ability to tailor—make coverages.

(5) Remuneration: Flexibility; Fees vs. Commission.

(6) Cost/References: Competitiveness; Other Client Opinions; Annual Reports.

Baltimore/Washington International Airport: The Mid-Atlantic's Emerging Gateway

(By T. James Truby, Administrator, State Aviation Administration, Maryland Department of Transportation)

Without air services and facilities, international trade cannot grow, cannot prosper and, in fact, cannot exist as we know it today. Of the world's international freight volume, air cargo represent 35 percent of the total shipped value. And whether goods are shipped by air or by surface, air transportation fosters essential face-to-face contact between trading partners. Recognizing this, the State Aviation Administration has developed BWI to the point where it not only offers a complete range of facilities and services in support of international trade, but is also emerging as the principal international air gateway for the Mid-Atlantic region.

PRESENT BWI AIRPORT SERVICES AND FACILITIES

1. Scheduled International Air Services: British Airways and Flying Tigers—World-wide; Eastern—Canada, Bermuda and South America; World—London,

Frankfurt; Icelandair—Iceland, Luxembourg; Air Jamaica—Jamaica; United—Far East.

2. Domestic air connections—over 600 flights daily on 35 airlines.

3. International freight facilitators—over 30 major customshouse brokers, ATA agents and international air freight forwarders and complete staff of highly trained U.S. Customs Inspectors.

4. Foreign Trade Zone (FTZ)—recently activated, aviation-oriented FTZ No. 73 within BWI Air Cargo Complex, as part of Maryland's system of foreign trade zones; 2 high tech users, numerous prospects, considerable expansion potential.

5. Cargo Handling Facilities: Nearly 300,000 square feet of covered warehouse space; over 17 acres cargo aircraft parking area; container and pallet loading equipment capable of handling any aircraft.

6. Passenger Handling Facilities—full service international departure and arrival facilities as integral part of main passenger terminal.

BWI INTERNATIONAL GATEWAY

Working in close coordination with the airlines, BWI is able to offer an ever expanding range of services as a result of increasing the Airport's penetration of the Balitmore-Washington market and surrounding hinterland. The securing of additional services in support of international trade is largely linked to the future development of BWI as an international gateway, where goods and passengers transfer between domestic and international transportation services—air to air, air to surface, and so on. Recognizing this, the State Aviation Administration, in conjunction with BWI's airlines and freight facilitators and the business and governmental leaders who compose the BWI Development Council, is working to realize BWI's gateway potential thru the following initiatives:

1. Urging partnerships between international and domestic airlines to facilitate passenger and cargo connections at BWI. (BWI's) geographic location and Piedmont domestic hub contribute to this effort.)

2. Urging implementation of expedited Immigrations and Customs clearance procedures at BWI.

3. Expanding international marketing of BWI.

4. Expanding passenger and cargo handling capacity in line with increasing demand. (BWI was the fastest growing U.S. international passenger gateway in 1983.)

The State Aviation Administration is always open to suggestions on how BWI can better support international trade. Interested parties should contact me directly.

To assist businesses in taking full advantage of BWI's international services and facilities, two members of our team are available:

Ms. Lynda Warehime—Manager, Passenger Services, Telephone 859-7032.

Mr. Franklin Potter—Assistant Director Air Service Development-Cargo, Telephone 859-7030.

STATE AND LOCAL SUPPORT FOR EXPORTING

(By Bernard L. Berkowitz, President, BEDCO, Tuesday, June 19, 1984)

Local government efforts to encourage increased international trade are still fairly rare in the United States. Happily, Baltimore is one of those rare instances of a concerted local economic development strategy aimed at encouraging investment and jobs related to international trade. This is being done in two ways. First, through the presence of a foreign trade zone, and second, through overseas marketing of Baltimore firms' products by a representative of my organization, the Baltimore Economic Development Corporation (BEDCO).

Baltimore City, the State of Maryland, and the Nation already benefit from the tens of thousands of jobs provided by our port and port-related industries. To increase the job benefit of the port, Baltimore City, through BEDCO applied for the designation as a foreign trade zone of 20 acres in our Holabird Industrial Park. We were, and are, interested in attracting businesses to set up plants in the zone to assemble products that require imported components. The attraction for the companies is reduced duties. The attraction for the city is an increase in the number of jobs and the tax base.

Foreign Trade Zone No. 74 was approved by the U.S. Department of Commerce in January 1982. That same month, after a competitive selection process started earlier, McCormick Properties Inc. was selected as the developer and operator of the

zone. This zone at the Holabird Industrial Park is now known as the Baltimore Freeport Centre.

Under the agreement with McCormick Properties, city funds are not being used to develop or operate the zone. The city has leased the land to McCormick which is responsible for the costs of development and operations. However, the city will share in the net profits as well as deriving the usual taxes on development.

The first building, with 58,000 square feet of multi-tenant space, has been completed and the Baltimore Freeport Centre was activated on April 19, 1983. In the last 8 months of 1983, the zone accommodated close to 2 million pounds of merchandise, with a value of $1.5 million, for more than a dozen separate users. However, we view this warehousing use as merely a step toward the more job-intensive, assembly-type activities being sought by McCormick and BEDCO.

In summary, BEDCO sees the FTZ as another tool to create new jobs and revenues at the former military installation. The site has the potential to generate between 400 and 800 jobs, and provide the city with about $350,000 a year in property taxes.

The FTZ functions as an additional growth incentive for local firms, and a significant enticement to companies not currently located in Baltimore. Local firms have the opportunity to establish branch operations within the designated area in order to enjoy the benefits of the zone. Firms from outside the Baltimore area, particularly foreign firms, may move to the city to take advantage of the foreign trade zone's unique cost-saving opportunities.

The second major international trade initiative of Baltimore is more unique than the Freeport Centre. As a result of Mayor Schaefer's request, Ralph Stephan, an experienced Foreign Service officer in the State Department was loaned to the city for 2 years under the State Department's Pearson Program for the purpose of promoting exports, joint ventures and reverse investment.

A survey of Baltimore firms resulted in indentifying about 70 companies, mostly small- and medium-sized, that wanted help entering the export market, increasing exports, or forming joint ventures with foreign businesses. Stephan visited these firms to become familiar with their products, markets, etc. He then undertook three trade development missions covering East Asia, Western and Southern Europe, the Middle East and Panama.

Literally, hundreds of leads were provided for Baltimore businesses. But, it takes a long time to translate a lead into an export sale. A year after completing his first mission, the first export sale occurred when a local high quality clothing manufacturer received an order from West Germany. The first joint venture resulting from Stephan's efforts is now nearing completion. Within the next several months, more and more of the fruits of Stephan's efforts will be harvested.

Finally, I want to mention a new BEDCO initiative in export assistance. We are gearing up to provide export financing assistance in much the same manner that we package financing for plant and machinery, except that we want to encourage firms to utilize the financing available through the Export-Import Bank and SBA. Ideally, our financing efforts should be closely coordinated with those of the Maryland Department of Economic and Community Development and the U.S. Department of Commerce. That is our intention, certainly.

Let me close by expressing my appreciation for the opportunity of describing our international trade related programs.

SUPPLEMENTAL STATEMENT OF BERNARD L. BERKOWITZ, PRESIDENT, BEDCO, DELIVERED ON MARCH 7, 1984, IN SUPPORT OF HB 994, TO ESTABLISH THE MARYLAND OFFICE OF INTERNATIONAL TRADE

Good afternoon. My name is Bernard L. Berkowitz and I am President of BEDCO, The Baltimore Economic Development Corporation. As you know, BEDCO is the City's agent for economic development. In this capacity we perform marketing, development and financing functions in an effort to retain existing businesses and attract new ones, thus providing jobs for our citizens as well as increasing the City's tax base.

Today I am here representing Mayor William Donald Schaefer to express the City Administration's support for HB 994, which would establish the Maryland Office of International Trade. Other States such as Illinois and Virginia have mounted recent new efforts to increase exports by their firms. Why? Quite simply because they realize that opening up and enlarging export markets translates into more jobs and

greater income. For example, it has been estimated that 40,000 jobs are created for each $1 billion worth of exports.

Thus, it makes great sense for Maryland also to undertake a vigorous, organized program to stimulate more international trade especially exports by firms located in the State. Such a program would benefit the State and its political subdivisions through increased sales, revenues and employment in Maryland businesses. In addition, and importantly, it would result in a greater volume of trade moving through the Port of Baltimore and, therefore, more business for the stevedoring firms, export management companies, freight forwarders, banks, etc. that serve the port.

In Baltimore City, we have been working on export promotion for the past year and a half. Through Mayor Schaefer's efforts, a U.S. State Department professional was assigned to BEDCO to work on export promotion. Baltimore City businesses interested in export assistance have been identified; catalogs and other product information have been assembled; and the products have been marketed overseas. The result has been literally dozens of solid leads for city companies which they are pursuing. As part of our cooperation with Baltimore County, this service has also been made available to county firms.

The program proposed by HB 994 would represent a quantum leap forward in export assistance. The bill proposes a larger State effort by establishing a new Office of International Trade within DECD. It also recognizes the importance of locating the office in the center of Maryland's international commerce, downtown Baltimore, where maximum coordination would be possible with organizations such as the U.S. Department of Commerce and BEDCO.

Significantly, we at BEDCO have been discussing a unified, coordinated international trade promotion effort involving the U.S. Department of Commerce (with its office in Baltimore), BEDCO and DECD as partners. In such an arrangement, Department of Commerce would help coordinate training seminars with State trade organizations on various aspects of the export process, provide reference and research facilities, maintain a data base on Maryland exporters and nurture contacts through its many foreign Commercial Service posts worldwide. Through the proposed new office, DECD could provide outreach marketing support using its own overseas offices and those of the Maryland Port Administration. BEDCO, on its part, would provide financing assistance by packaging Eximbank and SBA loans and insuring foreign receivables under a Foreign Credit Insurance Association policy for any firm in the State, not just City businesses. HB 994 would draw together the existing export development organizations and efforts in the State into a cohesive, comprehensive whole that should benefit Maryland's economy greatly.

One concern which we have about HB 994 is that it does not provide additional funding to operate the Office of International Trade. We would not want to see the new office funded by taking resources from other important DECD programs. As to the amount of money needed, we defer to DECD.

Thank you for the opportunity to address you and I urge your support for HB 994.

REMARKS BY RAYMOND G. HEINZELMANN, PH.D., DIRECTOR, WORLD TRADE DIVISION, DELAWARE RIVER PORT AUTHORITY, CAMDEN NJ, AT THE THREE-DAY TRADE PROGRAM FOR THE MID-ATLANTIC REGION, TUESDAY, JUNE 19, 1984

I think it would be useful if you first of all understand the involvement of the Delaware River Port Authority in the world of international waterborne commerce. The Delaware River Port Authority is a bi-state quasi-governmental agency of the States of Pennsylvania and New Jersey with three distinct areas of responsibility. The first of these obligations is to build and operate river crossings between Southeastern Pennsylvania and the adjacent areas in Southern New Jersey. Accordingly, it has built four highway bridges linking the two areas. Its second obligation is to provide rail mass transit between the two States, and it has provided a modern, mass transit communter system. Finally, the Port Authority promotes commerce on the Delaware River. The Authority's World Trade Division is responsible for this mission. The Division has a professional staff of 22 with four overseas regional trade development offices in Philadelphia, Pittsburgh, Chicago and New York, in addition to division headquarters in Camden, New Jersey.

The Delaware River Port complex, frequently referred to as the Ports of Philadelphia, which we promote, includes the Port facilities in Philadelphia, South Jersey—both Camden and Gloucester City—and in Wilmington, Delaware.

During 1983, the port complex, the largest on the East Coast, handled more than 54 million tons of international waterborne commerce. Most of the cargo, 43 million

tons, was oil and ore imports. Grain and coal exports accounted for 4 million tons, giving a ratio of 92 percent imports for the bulk commodities.

General cargoes amounted to 5.2 million tons during 1983 with exports accounting for 1.2 million tons, or 22 percent. Just 5 years ago, exports represented 31 percent of the total when they were at a level of 1.7 million tons. Since then, the ratio of exports to imports has been on a constant decline.

But there is reason for optimism. The first significant indication that this trend may be reversing was contained in the port performance statistics for the first quarter of 1984. At the Ports of Philadelphia, where general cargo tonnage increased by 33.7 percent, export tonnage gained 17 percent.

Historically, the Delaware Valley Region, which the Ports of Philadelphia service, has been an industrial center. But during the last decade, the industrial/manufacturing base has been eroded somewhat to be succeeded with a compensating growth in service industries such as high technology, legal services, banking and insurance—many of which are exportable services. However, such services are of no positive value to the Port.

The 3-to-1 import/export ratio for waterborne cargoes is not a healthy condition for the port, especially from the viewpoint of steamship accounting where balanced cargo movements inbound and outbound provide maximum efficieny. Our primary corrective action is to try to extend the reach of the port's market areas to attract exports to the port.

We recognize, however, that for the long-term health of the port, revitalization of export tonnage from the Delaware Valley region is essential. Projects and activities designed to generate new export cargoes, in which the port community is involved, are:

Participation in and support of the Philadelphia Export Network project, a program sponsored by the Wharton School of the University of Pennsylvania, which utilizes MBA students to carry out marketing studies and to prepare export marketing plans for businesses in the Delaware Valley. The program was started in October 1981. Since then, 60 firms have used the service utilizing 210 MBA's. As a result of this program, an estimated $6 million in export sales have been generated and 150 jobs created.

Two firms which participated in the program have received the Pennsylvania Governor's E Award in 1983.

Participation in the District Export Council of New Jersey and Pennsylvania.

Working with the Small Business Administration on Programs designed to bring potential exporters together with export management companies. Recently, a Matchmaking Conference was held in Philadelphia which attracted some 150 firms from the Delaware Valley region interested in developing export potential.

We work closely with the Federal and State Departments of Commerce on export-oriented workshops and seminars.

We work with the State Department of Commerce representatives in identifying commodities for export and we utilize our overseas offices in identifying potential markets.

We utilize our overseas representatives to assist exporters in identifying distributors for their products in foreign markets.

We arrange overseas business contacts for businessman from our region.

We arrange business contacts for overseas businessmen from our region.

We are involved in the development of a marketing information system that is made available to the exporting community. It helps businessmen identify foreign markets for their product lines. And we conduct workshops to assist businessmen in learning how to use this data.

We arrange overseas trade missions for the regional business community.

Although we are not presently actively involved in the development of an export trading company, we are closely observing the progress of others with the view of possible eventual involvement when capital funds for such a venture become available.

REMARKS BY COMMERCE SECRETARY MALCOLM BALDRIGE, BEFORE THE WASHINGTON-BALTIMORE REGIONAL ASSOCIATION SEMINAR ON EXPORT TRADING COMPANIES, BALTIMORE, MD, TUESDAY, JUNE 19, 1984

Thank you Governor (Harold) Hughes.

I also thank the Washington-Baltimore Regional Association and Senator Mathias for putting together this 2-day seminar on export services.

This is a good time to put some of the problems and opportunities of world trade in perspective and discuss what the Reagan administration is doing and has done to promote U.S. exports.

One thing we particularly need to put into perspective is the unwarranted fear that the high budget deficit is going to drive up interest rates, abort the current economic expansion and hurt the international economy, especially the economies of nations that must finance large external debts.

I am confident this will not happen. Interest rates are higher than we expected them to rise at the start of the year, but I don't see them getting high enough to derail the current expansion.

The Reagan administration is pursuing policies that I believe will neutralize these upward pressures. Rates were pushed up in February by the combination of Federal borrowing to finance the budget deficit and a surge in private credit demands.

However, we haven't experienced a "crowding out" of private credit demands, and the fiscal downpayment that will be made on the deficit this year should help lower rates before that occurs.

The deficit-reducing package of higher taxes and spending cuts now being put together will be followed by other deficit-cutting measures next year. Some have criticized the proposed three-year downpayment of $150 billion as too little, too late, and "back-end loaded."

But these critics forget three points. The first is that the President and Congress have agreed to act on the deficit despite the distractions of a national election year. Second, the spending and revenue adjustments made this year will grow into larger savings in future years. And third, the proposed package includes defense spending, non-defense spending and revenues. Therefore, I think the downpayment package being worked on will serve as an appropriate model for the crucial second deficit-reducing package that must be developed in early 1985.

That other deficit—the trade deficit—is going to set another record this year. Currently it is running at an annual rate of $126 billion. It will far exceed the 1983 record of nearly $70 billion even if it slows from that pace.

A number of complex factors have caused the deficit. One is the overvalued dollar which has pushed up the price of exports abroad and lowered the price of imports at home. Two major factors keep the dollar high—large flows of foreign capital into the United States and high real interest rates.

Direct foreign investment in the United States has declined, but capital inflow remains high even though the gap between domestic and foreign interest rates has narrowed some. I think these capital flows also will slow, however, as investment opportunities abroad improve even more, and U.S. interest rates decline. A drop in interest rates also will bring the dollar into better balance with other currencies.

A stronger economic recovery here than abroad also is contributing to the trade deficit.

The recovery figuratively has turned this country into a magnet for imports from our European and Latin trading partners. This year, imports are up 38 percent above last year. Exports have risen 7 percent. Simultaneously, our trading partners are practicing austerity to reduce their debts, and this has curtailed sharply the amount of imports they will accept. Exports to Latin America, for example, fell $16 billion from 1981 to 1983.

In this way, our trade deficit is transmitting our recovery abroad.

Increased imports to the United States are providing indebted Third World nations with the funds they need to finance or partially repay the principal on their debts. The projected $56 billion increase in this year's trade deficit will add eight-tenths of one percent to the GNP of the other free world nations. This added stimulus hasn't been sufficient to stimulate their economies enough to increase U.S. exports, but eventually it will.

That is the reason the administration considers it important to hold down interest rates.

Higher interest rates would add considerably to the interest payments our heavily-indebted trading partners owe the banks. We estimate that a 1.5 percent rise in interest rates would increase interest payments the 10 largest debtor countries owe the banks by $2.5 to $3 billion per year.

How do we solve these trade difficulties? Some—too many people—say we should turn protectionist. That's the worst possible solution.

It would lead to the same kind of global economic catastrophe we had in the 1930's when this country, along with other nations, took protectionist steps to try and insulate itself from the spreading world recession. The United States imposed the Smoot-Hawley tariff on imports, raising tariffs to their highest point in history—53 percent of added value. Other nations retaliated. They raised their own tar-

iffs, instituted exchange controls and erected other non-tariff barriers which in short order all but nullified the benefits of free trade.

The Reagan administration is resisting protectionist pressures, and will continue to resist them. I don't know of another country in the world that would tolerate the size trade deficit we have without protectionist responses.

The administration has opposed protectionist pressures on Capitol Hill and in U.S. industry because of the damage we know it would cause industrial competitiveness. That's why we successfully have fought protectionist legislation such as auto local content and worldwide steel quotas.

This has not prevented the administration from looking after the interest of U.S. business, however. When necessary, the administration has enforced U.S. antidumping and countervailing duty laws to provide American firms relief from unfair foreign trade practices. We have enforced the law even when some of our economically-troubled trading partners have pressured us against doing so.

We also have taken some steps detractors falsely have labeled protectionist.

Voluntary auto restraints are a case in point. At the time we negotiated the voluntary restraint agreements, there were 20 bills in the hopper for legislated import quotas on Japanese vehicles. Once enacted, those quotas would have been impossible to remove. We thought the voluntary agreements would be a better alternative. They provided the auto companies temporary relief without imposing permanent controls. The auto industry has used this breathing spell well, improving both its productivity and profitability.

Meantime, I think the administration has taken some meaningful long-range steps to improve the country's international competitiveness. We have worked hard and with some success in opening foreign markets to U.S. exports. We have gotten Japan to liberalize standards laws, reduce import duties on certain items and expand quotas on others. The May 29 agreement we reached with the Japanese on the yen/dollar will liberalize its capital markets, increase the value of the yen in the future, and help reduce our trade deficit with that country.

Japan, however, remains one of the most closed markets in the world and we are working to remove the many trade barriers that still exist.

We also have liberalized U.S. export controls on the transfer of technology to China and that has improved bilaterial relations considerably. Both countries will benefit from this more liberal policy. It will allow China to modernize its economy more rapidly, and lead to a doubling of U.S. exports of high technology to that country while permitting us to effectively enforce export control policies.

The administration also has acted in the legislative area to improve U.S. competitiveness abroad.

It proposed and got passed the Economic Recovery Act of 1981 which accelerated depreciation allowances and increased business incentive to make investments that will lead to innovations and higher productivity. This year's projected 14.8 percent increase in new plant and equipment—the largest annual rise since 1966—is a direct outgrowth of the accelerated depreciation allowances.

Many firms are taking advantage of accelerated depreciation to purchase productivity-improving equipment that will help them meet foreign challenges.

The administration also provided tax credits for research and development and proposed changes in antitrust laws to allow joint R&D ventures by private firms.

We also are encouraging limited R&D partnerships that will make domestic firms more competitive in the high technology area.

Of course, this administration also backed the landmark Export Trading Company Act of 1982 which has been covered in this 2-day seminar. The act is especially geared to bringing small and medium-sized firms into exporting. We have identified thousands of producers of goods and services we think could find foreign markets, and we hope to encourage many of them to become exporters over the years. A private study the Commerce Department commissioned a few years ago showed that export trading companies can yield significant economic benefits.

That study projected that within 5 years ETC's sales could add billions of dollars to the economy, create thousands of jobs, and reduce the Federal deficit significantly. However, this will occur only if firms strengthen their competitive position in overseas markets. Much of this strengthing can be accomplished by taking advantage of the opportunities presented by the Export Trading Company Act. I think that when no strong regional banking presence or private sector consortia emerges to spearhead export trading company development, the jurisdictions themselves should take the initiative.

The statute allows State and local governments to form ETC's and apply for a title III certificate which will protect specific conduct from antitrust action. Your port authority, for example, can form an ETC and put together joint export activi-

ties that will help reduce individual risks and achieve economies of scale among groups of small producers.

Your neighbor, the Virginia Port Authority, has formed a non-profit trade intermediary called VEXTRAC.

VEXTRAC is just getting off the ground. Once it is in complete operation, it will provide exporters with marketing and transportation services and arrange for financing. Under the title III certificate granted the trading company, it can solicit proprietary data from individual competing producers to determine the feasibility of pooling their products or services for exporting. VEXTRAC's certificate also permits it to require that exporters using its services ship through Virginia ports and use VEXTRAC as their intermediary in arranging financing and transportation services.

Public sector ETC's can be a valuable tool for governmental units to use to assist local firms in sellling products and services in the international marketplace. I would emphasize that public sector ETC's should not be organized to compete with private sector exporters. They should only fill the gap when there is no private presence, or when the services they provide are of the type best provided by the public sector. Most importantly, the public sector should be the catalyst stimulating export trading company growth.

Maryland currently is exporting about $1.2 billion in manufactured goods annually. Approximately 26,000, or 2.6 percent, or your jobs are directly or indirectly tied to exports. Nationally, an average of 4.7 percent of all civilian employment is related to exports. The Export Trading Company Act should be viewed and used as a new tool for economic development. Exports do mean jobs.

I think there is an opportunity for far higher exports by this region, and I urge you to take advantage of it. I know this seminar is a step in that direction. I congratulate you on holding it, and thank you for giving me an opportunity to participate.

Programs To Support Exports by Small Businesses

(By Garrett Boyd, Export-Import Bank of the United States)

The Export-Import Bank of the United States is the U.S. Government agency which offers loan, guarantee and insurance programs to supplement and facilitate the private sector financing of U.S. export sales.

Eximbank pays special attention to the needs of smaller exporters and small firms with export potential that are not yet exporting. In the first half of fiscal 1984, Eximbank authorized $625 million in assistance for exports by small businesses, or 21.1 percent of its total authorizations during the period.

Under Eximbank's export credit insurance programs, administered by the Foreign Credit Insurance Association [FCIA], 65 percent of all policies issued in the 6 months were for small businesses. In addition, 77 percent of all quotes for new policies outstanding at the end of March were for small businesses.

Eximbank defines small businesses according to the standards that should be familiar to all small companies: those set by the Small Business Administration. The SBA guidelines are based on either sales volume or number of employees for each industry, by SIC code.

Each of Eximbank's export support programs is available to and is being used by small exporters. Some programs are specially tailored to assist small businesses.

The Working Capital Guarantee, enables small companies to obtain critical preexport financing from commercial sources. Through the end of March 1984, Eximbank had approved 13 working capital guarantees assisting companies exporting aviation parts, computers and office equipment, lumber, recreation and sports equipment, metal processing equipment and specialty metals. To facilitate use of the program, Eximbank is improving and standardizing the application process. It has also reached an agreement in principle with the Small Business Administration to coordinate its program more closely with their similar export revolving line of credit guarantee program.

The Small Business Credit program enables small companies to arrange commercial bank export loans for their medium-term sales with interest rates fixed at the lowest levels permitted under internationally adopted guidelines of the Organization for Economic Cooperation and Development. The Small Business Credit program, unlike Eximbank's other loan programs, does not require evidence of subsidized foreign competition. Small Business Credit authorizations in the first 6 months of fiscal

1984 totaled $21.7 million, an increase of 57.2 percent over the level in the first 6 months of fiscal 1983.

The FCIA "New-to-Export" insurance policy provides an excellent entry mechanism into international sales. It offers greater protection against the risks that foreign customers will not pay for their credit purchases, at reduced minimum premiums, compared to policies available to more established exporters. To make the New-to-Export policy even more attractive and useful, in March Eximbank adopted a "hold harmless" provision to encourage banks to accept assignment of the proceeds of these policies from small businesses as collateral for loans.

Another change which assists all FCIA insurance policyholders, new-to-export or otherwise, was the extension of cover for interest on claims to the date of payment, rather than to the date of default. This improvement will be especially beneficial to smaller companies, who feel the effects of non-payment more acutely than larger firms.

Eximbank has developed a new "Umbrella" insurance policy which will be made available to small and medium-sized banks, export trading companies, state export finance agencies, export financing cooperatives, small business investment companies, and other appropriate entities, beginning July 1. This new policy will enable the insured parties to extend short-term insurance coverage to credit sales by new and inexperienced exporters. These exporters thus will have repayment protection, without the administrative burdens of holding their own individual policies.

Eximbank is pursuing extensive communication and marketing programs to increase the use of its services by small and medium-sized exporters.

Eximbank's Directors, officers and other staff members have been following a very active travel schedule to speak to a wide variety of groups. In the first half of fiscal 1984, they made 233 trips covering 23 States.

In fiscal 1984, Eximbank is conducting a series of 37 regional export conferences for small businesses across the country. In the first 16 of these meetings, attendance totaled 1,430.

In Eximbank's Washington offices each month, a 1-day briefing session is scheduled for groups of exporters and potential exporters, and two 2-day briefing sessions are scheduled for commercial bankers. Each session includes a full overview of the Bank's policies, operations and services and is offered at no charge.

Special working meetings are also conducted with panels of exporters, export trading companies, banks and insurance brokers, with associations, such as the National Association of State Development Agencies, and with trade and finance specialists from the Department of Commerce and the Small Business Administration.

Any small company that has a question relating to exporting can receive advice and assistance from Eximbank with a call to the toll-free hotline telephone number (800-424-5201). This advisory service has been especially active this year. In the first half of fiscal year 1984, 5,500 calls for assistance were received on the special number. In the month of February alone, Eximbank received 1,456 calls—the highest monthly total since the service was initiated 5 years ago.

Eximbank has assigned six employees to work full-time on a marketing task force. In addition, all of the Bank's regular loan officers are advising and counseling small businesses daily in how to use its various programs. It has contracted with a professional firm, Needham Porter Novelli, to develop an effective communication and marketing effort. It is developing a new series of descriptive materials to help companies understand and use its services. It has brought in representatives from the Foreign Credit Insurance Association, the Department of Commerce, the Small Business Administration, and several State government agencies for in-depth training in Eximbank's programs so that they can effectively act as marketing agents and distributors in the field.

In this connection, Eximbank has stepped up its program of calling on commercial banks, and will help train commercial bank employees in the operations of Eximbank's programs in their own offices.

James Yonge, a former small businessman from Florida, is the Bank's Director designated to oversee its small business activities. John Bohn, First Vice President and Vice Chairman, is responsible for overseeing marketing efforts, and is thus very active in helping to reach small companies.

The Bank's 12-member Advisory Committee includes three small business representatives: Gordon O. F. Johnson, Chairman of the Board of Logetronics, Inc., of Springfield, Virginia, who is former Chairman of the Small Business Working Group of the U.S. Chamber of Commerce Export Policy Task Force; Ralph Chew, President and Chief Executive Officer of the A. E. Chew Company, Inc., of New York, and President of the National Association of Export Companies; and Wayne

P. Moore, President and Chief Executive Officer of the Moore Special Tool Company, Inc., of Bridgeport, Connecticut.

FOUR-STATE CAMPAIGN

Eximbank will conduct an intensive test-marketing campaign in a 4-State area: Illinois, Michigan, Minnesota and Wisconsin. These States were selected because together they account for about one-fourth of U.S. exports, they have a well-diversified exporter base, they have a highly developed banking system, and they have State government programs to encourage exports.

Eximbank will be trying a number of initiatives in the 4-State area, and monitoring their success, in order to develop a national program.

To increase awareness and understanding of the programs, Eximbank will be conducting an active marketing and promotional campaign, including use of direct mail advertising and other appropriate resources.

To increase the distributors for the programs, Eximbank will be emphasizing two programs, the working capital guarantee and the new FCIA "umbrella" insurance policy.

The working capital guarantee enables small companies to obtain critical pre-export financing from commercial sources. In the 4-State area only, any commercial bank wishing to participate may have delegated authority to commit Eximbank's 90 percent guarantee cover for working capital loans of up $300,000 per qualified exporter.

In the 4 States, the new "Umbrella" insurance policy will be actively marketed to small and medium-sized banks, export trading companies, State export finance agencies, export financing cooperatives, small business investment companies, and other appropriate entities, to encourage sales by new and inexperienced exporters. These exporters thus will have payment protection without the administrative burdens of holding their own individual policies.

A system of field support for exporters in the 4 States has been set up. Eximbank is providing extended training for nine Commerce trade development specialists in the 4-State area. Personnel in FCIA's Chicago office have been assigned to work full-time on this special marketing campaign. Eximbank has met several times with representatives of the four State governments, and will continue to work closely with them as the campaign develops. These organizations will be able to provide on-the-spot assistance to enable companies to understand and use our services.

The results of this trial campaign will be carefully reviewed and evaluated throughout the test period. Upon completion, they will form the basis for a nationwide program which should measurably increase the Bank's assistance to small and medium-sized exporters.

SBA'S EXPORT REVOLVING LINE OF CREDIT [ERLC]

(By Justin Palmisano, U.S. Small Business Administration, Baltimore District Office)

SBA LOAN PROGRAM

SBA offers a variety of loans and financial assistance to eligible small businesses, to privately-owned small business investment companies and local development companies.

Types of loans

1. The bulk of SBA's business loans are made by private lenders with *Guarantees* by SBA.

2. Very few business loans are made *directly* by the Agency.

NOTE: In fiscal year 1982, SBA approved 28,740 business loans, worth $3.2 billion, with an average loan value of $79,000. This includes both types of loans.

ERLC PROGRAM OBJECTIVES

Provides eligible small businesses with the financial resources necessary to establish or expand export sales without duplicating the functions or services of available financial institutions.

WHAT TYPE OF BUSINESS LOAN IS IT?

ERLC funds are available only under the Guaranty Program. The loan is made by private lenders, usually banks, and guaranteed by SBA.

ERLC has a revolving feature, where any number of withdrawals and repayments can be made as long as the dollar limit of the line is not exceeded and the disbursements are made before maturity.

WHAT ARE THE TERMS OF THE LOAN?

The maturity of an ERLC cannot exceed 18 months, including all extensions.

No provision exists for renewals but borrowers can reapply for a new line upon expiration of an existing ERLC.

A new line may not be used to pay off an existing line of credit.

WHAT IS THE AMOUNT OF THE LOAN?

SBA can guarantee up to 90 percent of a bank line of credit.

An applicant may have other SBA loans in addition to a ERLC as long as the total outstanding balance of all such loans does not exceed $500,000 for SBA's share.

Applicant can have one or more ERLC outstanding at any given time.

NOTE: This does not limit the banks from making larger loans, however, SBA's share will not exceed $500,000.

WHAT ARE ACCEPTABLE USES OF THE PROCEEDS?

Finance labor and material needed for manufacturing or wholesaling products for sale overseas. Funds may be used for current expenses, including purchase of supplies, inventories, materials and working capital.

Funds can also be used to develop and penetrate foreign markets. Examples of eligible expenses include: Professional export marketing advice and services, foreign business travel or participating in trade shows, etc.

Funds may *not* be used to pay existing obligations, nor, to purchase fixed assets (other SBA programs can be used for these needs).

BASIC WAYS FOR SUBMITTING ERLC APPLICATIONS

1. Single line of credit to cover all the borrower's anticipated needs during the loan period, with advances made against one or more sales contracts during the period.

2. Multiple lines may be made available with applications filed for each line, provided that the amount of all loans outstanding and committed at any one time does *not* exceed SBA's statutory lending limit.

WHAT TYPE OF BUSINESSES ARE ELIGIBLE?

Type 1: Manufacturer or wholesaler.

Type 2: Export management company (EMC) and Export Trading Company (ETC).

Type 3. Architectural & Engineering firm (A & E).

An (EMC) is classified as:

A. "Service Firm" is it represents other firms in overseas sales.

B. "Wholesaler" if it buys product for its own account and then sells it overseas.

Loan applicants must have been in business (not necessarily in exporting) for at least 12 months prior to filing an application.

WHAT IS THE BUSINESS SIZE ELIGIBILITY REQUIREMENT?

An applicant must qualify as "small" business under the SBA size standards. Generally, size requirements are:

1. Manufacturing: Maximum number of employees may range from 500 to 1,500, depending on industry in which applicant is primarily engaged.

2. Wholesaling: Maximum number of employees may not exceed 500.

3. Service: SIC Code 7392, "Management consulting and public relations services". Average annual receipts for the last 3 fiscal years must not exceed $3.5 million.

SIC Code 8911, "Architectural and Engineering Services". Average annual receipts for the last 3 fiscal years must not exceed $3.5. to $13.5 million, depending on type of service.

WHAT IS THE INTEREST RATE?

Lenders may charge up to two and one-quarter percent over the minimum prime rate reported in the Wall Street Journal.

ARE THERE ADDITIONAL FEES?

There are some (commitment, guaranty and service) fees that the bank can charge, which are not prohibitive.

WHAT ARE THE ADDITIONAL FEES?

Fee	Percentages	Loan maturity	Condition
Guaranty fee	One-fourth percent of the portion guaranteed by SBA.	12 months (short term)	Fee must accompany the loan application.
	1 percent of the portion	12months to 18 months.	
Commitment fee	One-fourth percent of the total loan amount.		Minimum of $200 (SBA receives no portion of this fee). Cannot be charged until SBA has approved the request for guarantee.
Service fee[1]	Up to 2 percent of the outstanding balance of the loan involving inventory or accounts receivable collateral.		SBA'S written permission.

[1] If servicing of receivables is necessary.

WHAT ARE THE COLLATERAL REQUIREMENTS?

Accounts receivable, inventories, assignment of contract proceeds and bank letters of credit and appropriate personal guarantees.

Collaterals must be located in U.S.A., or other assets under jurisdiction of U.S. Courts.

Collateral may include such items as bank letters of credit, insured receivable (normally by foreign credit insurance association, FCIA), or any other assets under the jurisdiction of U.S. Courts.

SBA may not guarantee a letter of credit, nor may proceeds by used to secure a letter of credit.

WHAT ARE THE CREDIT REQUIREMENTS?

A loan applicant must: Be of good character. Show ability to operate a business successfully. Must have been in operation for at least 12 months prior to filing an application. (This requirement may be waived for good cause by the Assistant Regional Administrator for Finance & Investment). Show that the proposed loan is of such sound value, or so secured to assure repayment.

WHAT ARE THE SPECIAL APPLICATION REQUIREMENTS?

1. A monthly cash flow schedule for 12 months or the duration of the loan. It has to clearly identify the amount requested and the projected amount outstanding under each line of credit at the end of each month. It has to be updated during the effective period of the line of credit, to show significant changes as they become known.
2. Must be current on all payroll taxes and have in operation a depository plan for the payment of future withholding taxes.

WHERE TO START?

Prospective applicants should review the export financing needs with their bank of account. Ask for a direct bank loan to fulfill your needs.

Sometimes the smaller bank branches are not fully aware of the international trade financial instruments and you may be referred to their international division at their main branch.

If the bank is unable or unwilling to make the loan directly, ask the bank to make the loan under SBA's loan guarantee plan.

If the bank is interested in an SBA guaranteed loan, ask the banker to contact SBA's Chief of the Financing Division (District Office) for discussion of your application. The participation of a private lender is necessary in order to consummate an export revolving line of credit.

In most cases of guaranteed loans, SBA will deal directly with the bank rather than the borrower.

Trade Promotion by the U.S. Trade and Development Program

(By Christian R. Holmes, Director, Trade and Development Program, June 19, 1984)

I appreciate this opportunity to speak about the U.S. Trade and Development Program (TDP) and the ways in which TDP can assist exporters from the Mid-Atlantic region in their activities overseas. First I would like briefly to describe the Program and how it operates and then to provide a few examples of projects in which we have been involved.

The Trade and Development Program, along with the Overseas Private Investment Corporation and the U.S. Agency for International Development [AID], is a component agency of the International Development Cooperation Agency. TDP promotes economic development in Third World countries by financing planning services for development projects leading to the export of U.S. goods and services.

TDP's goals are to: (1) promote the use of U.S. exports in major projects in the developing countries, (2) contribute to the development efforts of friendly countries in the Third World, and (3) facilitate open and fair access to natural resources of interest to the United States. By assisting U.S. firms to export U.S. goods and services in major projects, TDP-financed activities also lead to job creation in the United States and improvement in the U.S. trade balance with Third World countries.

TDP finances feasibility studies and other planning services for major projects through which developing countries receive comprehensive access to U.S. advanced development technologies and project planning skills from the U.S. private sector. These advanced skills and technologies, crucial to development efforts, are often not available within the developing countries and must be solicited from countries like the United States. TDP will finance the project planning services only on condition that they are conducted by American firms. When feasibility studies are carried out by U.S. firms, U.S. contractors are more likely to be selected to manage the downstream project and U.S. equipment and technology is more likely to be used. Therefore, prospects for the use of U.S. technology and equipment in the implementation stage of these projects are improved while the engineering assistance provided by the studies help lay the groundwork for the priority development projects. As you can see, therefore, TDP is both a trade agency and a development agency.

Our formula has been very successful. Since the establishment of this agency in 1980, TDP's total program expenditure of approximately $26 million has generated, according to the U.S. business community, at least $500 million in exports from the United States, representing more than 15,000 U.S. jobs. Probable and possible exports over the next few years, taking into account the time required for further project development and for add-ons to prior equipment and consulting contracts, should substantially increase the number of exports generated and jobs created. These exports have in turn transferred needed technology to developing countries to build major projects which have helped strengthen their economies.

THE TDP PROGRAM

TDP has distinct programs for public sector and private investor projects. For public sector projects, such as large scale energy, infrastructure and industrial projects, frequently financed by the World Bank or regional development banks, TDP assists the developing country governments with government-to-government grants which finance planning services provided by U.S. engineers, planners and technicians with expertise frequently lacking in these countries. This funding is provided on condition that a U.S. firm does the study. However, we do not give any particular U.S. firm preferential status. Planning services for all major non-investor projects in which TDP participates are undertaken by U.S. firms chosen through

the use of Federal competitive procedures or through the use of internationally accepted World Bank competitive selection procedures.

For private investor projects, on the other hand, when potential project opportunities are being pursued by U.S. investors who intend to invest equity in the project overseas, TDP will consider providing, on a 50/50 cost-shared basis, a reimbursable grant as risk capital to assist in the analysis of the feasibility of the project. If the project proves feasible and an investment is made, TDP requires reimbursement of the amount of its contribution to the study. If the project is not feasible, the TDP contribution is forgiven.

TDP PROJECT CRITERIA

To receive TDP funding all proposed projects must meet the following TDP criteria:

(1) The project must be high on the list of development priorities of the host country;

(2) The project must have the potential to generate significant U.S. exports. We use as an internal guideline for considering projects that each dollar which TDP spends of a feasibility study or other planning activity should generate at least one hundred dollars in U.S. exports;

(3) The project must have substantial likelihood of obtaining project financing; and

(4) The projects must show a need for a facilitative role from TDP. We will not provide assistance where procurement of U.S. technology is likely to proceed without TDP intervention, or where U.S. technology is unlikely to be employed regardless of the occurrence of TDP financial planning services.

In the course of assessing these projects, the TDP staff consults with the Department of Commerce as to the competitiveness of U.S. services and products in the project; ascertains the interest of appropriate financial institutions in project financing; confirms with the U.S. Embassies the development priority accorded the project; and coordinates with other U.S. government agencies, such as the Overseas Private Investment Corporation and the Export-Import Bank, regarding their possible involvement in the project.

TDP is one of the few forms of U.S. Government funding which can be extended to middle income countries and countries which are not eligible to receive U.S. foreign assistance from the Agency for International Development, such as China, Brazil, Korea, Turkey and the oil producing countries.

We are active in many sectors such as energy development, telecommunications, transportation, minerals development, industrial development and agribusiness.

We have the ability to respond quickly to assistance requests. All that is necessary is a letter to us describing the project, the potential U.S. exports, the potential sources of financing and the contacts which the firm has had with the foreign government. The letter should be sent to: Director, Trade and Development Program, Department of State, Washington, D.C. 20523.

A few examples of TDP projects involving firms from the Mid-Atlantic region in major projects overseas are the following:

Belize—TDP cofinanced with Kenaf International of Maryland a feasibility study of the construction of pulp and paper manufacturing facilities in Belize and the marketing of pulp and paper products from Belize within the Caribbean Basin region, and to mills and other U.S. customers on the Gulf Coast rim (i.e. from Texas to Florida). The project could generate up to $100 million in U.S. exports over a 10-year span.

Costa Rica—Communication Corp. Int'l of Virginia did a feasibility study of cellular telephony in Costa Rica for expansion of telephone services to rural areas. The export potential for U.S. telecommunications equipment is approximately $36 million.

Peru—Airways Engineering of Virginia performed the feasibility study of the design and construction of a new airport to facilitate access to a major world tourist attraction. U.S. export potential is approximately $36 million.

Yugoslavia—Bethlehem Steel of Pennsylvania is undertaking a feasibility study this year of the technical aspects for a proposed comprehensive pollution control for the RMK Iron and Steel Works at Zenica. The U.S. export potential of this project is approximately $50 million.

Thailand—The feasibility study for the construction of the Ao-Phai Coal Fired Power Plant was done by Burns & Roe and resulted in a follow-on contract to that firm for preliminary engineering design. Burns & Roe expects to get an engineering contract for the total project, which would be worth $15 to $20 million.

Thailand—Fertilizer Project—TDP financed in 1983 a feasibility study undertaken by Foster Wheeler Int'l Corp. of New Jersey. The project could generate $160 million in U.S. exports.

Morocco—TDP financed an oil shale workshop in fiscal year 1980. Vibra Screw Inc. and Ingersoll Rand, both of New Jersey, are two of the principal U.S. suppliers for imported equipment amounting to $1.13 million disbursed to 24 U.S. suppliers for a test station. Feasibility studies and construction awards have yet to be made.

In summary, the Trade and Development Program is an important instrument for the United States Government to fund feasibility studies of major projects which, directly or indirectly, represent, we hope, first-rate overseas trade opportunities for you. Our strategy has been to finance feasibility studies on projects which will ultimately be financed by the host governments or other sources, which will help the countries' development efforts and which will generate exports from the United States. We operate only an a project basis and seek to avoid financing feasibility studies on projects which have little chance of proceeding beyond the feasibility study stage.

I would be pleased to answer any questions you might have on our program.

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